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## Federal Trade Commission Permanent Injunction Actions Against Unfair and Deceptive Practices: The Proper Case and the Proper Proof

Arthur B. Cornell Jr.

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## FEDERAL TRADE COMMISSION PERMANENT INJUNCTION ACTIONS AGAINST UNFAIR AND DECEPTIVE PRACTICES: THE PROPER CASE AND THE PROPER PROOF

ARTHUR B. CORNELL, JR.\*

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## I. INTRODUCTION

In 1980 the Federal Trade Commission ("Commission") unveiled a new weapon in its consumer protection arsenal: the use of section 13(b) of the Federal Trade Commission Act ("FTC Act" or "the Act")<sup>1</sup> to obtain injunctions against unfair and deceptive

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<sup>1</sup> Federal Trade Commission Act of 1914, ch. 311, § 13(b), 38 Stat. 717, as added Mar. 21, 1938, ch. 49, § 4, 52 Stat. 111, 114 (codified as amended at 15 U.S.C. § 53(b) (1982)) [hereinafter *FTC Act*]. Section 13(b) states:

(b) Temporary restraining orders; preliminary injunctions

Whenever the Commission has reason to believe—

(1) that any person, partnership, or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and (2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public—the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond: *Provided, however*, That if a complaint is not filed within such period (not exceed-

practices.<sup>2</sup> In these federal district court actions, the Commission can also secure money judgments to redress consumers' injuries. The Commission pursues these actions without any prior or subsequent administrative proceedings thereby allowing it to move swiftly against targets it could not ordinarily reach through its administrative cease and desist orders, especially those committing "hardcore" fraud. In bringing these actions, the Commission forgoes its traditional roles as expert administrative judge and policymaker. It is the courts, not the Commission, which interpret and apply the FTC Act in these actions. The Commission only prosecutes. Section 13(b) does not clearly delimit the scope of the Commission's new power to seek permanent injunctions. This Article attempts to define limits that will make these actions effective without interfering with the Commission's policymaking role.

The source of the Commission's new found injunctive muscle is the second proviso of section 13(b).<sup>3</sup> Congress enacted section 13(b) primarily to authorize the Commission to seek preliminary injunctions during pending administrative cease and desist proceedings.<sup>4</sup> However, Congress added a second proviso, which states "[t]hat in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction."<sup>5</sup>

This simple one line grant authorizes the courts to fashion any equitable remedy reasonably necessary for complete justice in light

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ing 20 days) as may be specified by the court after issuance of the temporary restraining order or preliminary injunction, the order or injunction shall be dissolved by the court and be of no further force and effect: *Provided further*, That in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction. Any such suit shall be brought in the district in which such person, partnership, or corporation resides or transacts business.

*Id.* (emphasis in original). [References to section 13(b) actions in the remainder of this Article refer to actions for permanent relief, not temporary relief in anticipation of administrative proceedings.]

<sup>2</sup> The first reported opinions on section 13(b) actions are found in cases filed in 1980. See *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107 (9th Cir. 1982); *United States v. National Dynamics Corp.*, 525 F. Supp. 380 (S.D.N.Y. 1981); *FTC v. Virginia Homes Mfg. Corp.*, 509 F. Supp. 51 (D. Md.), *aff'd*, 661 F.2d 920 (4th Cir. 1981). In addition to actions aimed at generally "unfair and deceptive" practices, the Commission is using section 13(b) permanent injunction actions to enjoin violations of trade regulation rules and other statutes which it enforces. *E.g.*, *United States v. JS & A Group, Inc.*, 716 F.2d 451, 457 (7th Cir. 1983) (violation of Mail Order Rule, 16 C.F.R. § 435 (1986)); *FTC v. Virginia Homes Mfg.*, 509 F. Supp. at 54 (violation of Magnuson-Moss Warranty Act).

<sup>3</sup> See *supra* note 1.

<sup>4</sup> See *infra* notes 90-95 and accompanying text.

<sup>5</sup> FTC Act, § 13(b), 15 U.S.C. § 53(b) (1982); see *supra* note 1 (text of § 13(b)).

of the purposes of the FTC Act.<sup>6</sup> In the cases to date, the Commission has used this broad grant of authority to achieve impressive results.<sup>7</sup> In several cases the Commission has swiftly and effectively shut down deceptive schemes through temporary restraining orders,<sup>8</sup> preliminary injunctions,<sup>9</sup> asset freeze orders,<sup>10</sup> and appointments of receivers.<sup>11</sup> The first actions were against companies that sold investments, such as, oil and gas leases and related investments,<sup>12</sup> gemstones,<sup>13</sup> and work-at-home manufacturing operations.<sup>14</sup> The more recent section 13(b) actions have alleged deceptive practices in other areas, including adoption services,<sup>15</sup> home

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<sup>6</sup> See *Porter v. Warner Holding Co.*, 328 U.S. 395, 399-400 (1946). See also *infra* notes 209-15 and accompanying text.

<sup>7</sup> See *infra* notes 8-18 and accompanying text.

<sup>8</sup> E.g., *FTC v. Kitco of Nev., Inc.*, 612 F. Supp. 1282, 1286 (D. Minn. 1985); *FTC v. Alaska Land Leasing, Inc.*, No. 84-5416 AWT (Px) (C.D. Cal. filed July 23, 1984) (temporary restraining order issued ex parte July 23, 1984); *FTC v. Kimberly Int'l Gem Corp.*, No. 83-5268 MRP (GX) (C.D. Cal. filed Aug. 15, 1983). See also *Commodity Investment Fraud II: Hearings Before the Perm. Subcomm. on Investigations of the Senate Comm. on Governmental Affairs*, 98th Cong., 2d Sess. 220-22 (1984) [hereinafter *Fraud Hearings*] (appendix to prepared statement of Amanda Pedersen, Deputy Director, Bureau of Consumer Protection, FTC).

<sup>9</sup> E.g., *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431, 1432 (11th Cir. 1984); *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1110 (9th Cir. 1982); *FTC v. Kitco*, 612 F. Supp. at 1286. See also *Fraud Hearings*, *supra* note 8, at 220-22.

<sup>10</sup> E.g., *FTC v. U.S. Oil & Gas*, 748 F.2d at 1432; *FTC v. H.N. Singer, Inc.*, 668 F.2d at 1109; *FTC v. Kitco*, 612 F. Supp. at 1286; *FTC v. R.A. Walker & Assocs.*, 37 Bankr. 608, 610 (D.D.C. 1983); See also *Fraud Hearings*, *supra* note 8, at 220-22.

<sup>11</sup> E.g., *FTC v. U.S. Oil & Gas*, 748 F.2d at 1432; *FTC v. Alaska Land Leasing, Inc.*, No. 84-5416 AWT (Px) (C.D. Cal. filed July 23, 1984) (receiver appointed Sept. 30, 1984); see also *Fraud Hearings*, *supra* note 8, at 220-22.

Several firms shut down or filed bankruptcy shortly after the Commission secured preliminary relief. E.g., *FTC v. Alaska Land Leasing, Inc.*, No. 84-5416 AWT (Px) (C.D. Cal. filed July 23, 1984). In *Alaska Land*, Alaska Land Leasing went out of business and two other defendants filed bankruptcy petitions. See *In re David Kane*, No. 384-31605-A-11 (N.D. Tex. filed Oct. 15, 1984); *In re Federal Lease Filing Corp.*, No. 384-31438-A-11 (N.D. Tex. filed Sept. 4, 1984). See also *FTC v. Evans Prods. Co.*, 775 F.2d 1084, 1086 (9th Cir. 1985) (defendant Evans Products filed for bankruptcy); *FTC v. R.A. Walker & Assocs.*, 37 Bankr. at 610 (defendant filed for bankruptcy after Commission secured an asset freeze order).

<sup>12</sup> See *FTC v. U.S. Oil & Gas Corp.*, 748 F.2d 1431 (11th Cir. 1984) (per curiam), *aff'g* No. 83-1702 (S.D. Fla. 1983).

<sup>13</sup> See *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,506, at 68,458 (N.D. Cal. 1983); *FTC v. Kimberly Int'l Gem Corp.*, No. 83-5268 MRP (GX) (C.D. Cal. filed Aug. 15, 1983).

<sup>14</sup> See *FTC v. Kitco of Nev., Inc.*, 612 F. Supp. 1282, 1287-90 (D. Minn. 1985).

<sup>15</sup> See *FTC v. Kelley*, No. 85-0736-S (D. Mass. filed Feb. 19, 1985).

sales,<sup>16</sup> weight reduction plans,<sup>17</sup> and baldness cures.<sup>18</sup> The Commission has secured permanent injunctions against both corporations and individuals<sup>19</sup> and has collected judgments ranging from \$65,000<sup>20</sup> to \$6,700,000<sup>21</sup> to redress consumer injuries. These amounts represent only a small fraction of actual consumer losses.<sup>22</sup> The Commission, like other law enforcement agencies, has found it very difficult to recover money from the defendants running these fraudulent operations.<sup>23</sup> The \$6,700,000 judgment in *FTC v. International Diamond Corp.*, for example, was satisfied primarily by the defendant's corporate insurance policies.<sup>24</sup> Meaningful recovery, however, is possible. In *FTC v. U.S. Oil & Gas Corp.*,<sup>25</sup> the receiver collected over \$12,000,000 which may be made available for consumer redress.<sup>26</sup> The money already collected represents approximately twenty percent of consumers' losses.<sup>27</sup>

The Commission's section 13(b) actions seeking permanent in-

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<sup>16</sup> See *FTC v. R.A. Walker & Assocs.*, No. 83-2962 (D.D.C. filed Oct. 5 1983).

<sup>17</sup> See *United States v. Intra-Medic Formulations, Inc.*, No. 85-2819 (S.D. Fla. filed Aug. 11, 1985).

<sup>18</sup> See *id.*

<sup>19</sup> E.g., *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. ¶ 65,725 (N.D. Cal. 1983) (permanent injunction against one corporation and four individuals); *FTC v. First Petroleum Corp.*, No. 82-2744 CIV-EPS (S.D. Fla. filed Dec. 21, 1982) (permanent injunction against one corporation and three individuals). See also *Fraud Hearings*, *supra* note 8, at 220-22.

<sup>20</sup> See *FTC v. Adler*, 51 Antitrust & Trade Reg. Rep. (BNA) 822 (D.R.I. Dec. 4, 1986) (stipulated final order filed).

<sup>21</sup> See *FTC v. International Diamond Corp.*, No. 82-0878 WAI (JSB) (N.D. Cal. Mar. 4, 1982) (\$6.7 million award), reported in *Fraud Hearings*, *supra* note 8, at 220. Other redress awards have been secured by the Commission. See, e.g., *FTC v. Standard Fin. Management Corp.*, 52 Antitrust & Trade Reg. Rep. (BNA) 337 (D. Mass. Feb. 13, 1987) (\$1,500,000 in redress awarded); *FTC v. Trans-Alaska Energy Corp.*, 52 Antitrust Trade & Reg. Rep. (BNA) 269 (C.D. Cal. Jan. 8, 1987) (\$100,000); *FTC v. Leland Indus.*, 49 Antitrust & Trade Reg. Rep. (BNA) 669 (C.D. Cal. order filed Oct. 11, 1985) (\$2,500,000); *FTC v. Kimberly Int'l Gem Corp.*, 49 Antitrust & Trade Reg. Rep. (BNA) 439 (C.D. Cal. Aug. 26, 1985) (\$280,000); *FTC v. J & R Mktg. Corp.*, 48 Antitrust & Trade Reg. Rep. (BNA) 881 (S.D. Fla. May 10, 1985) (\$700,000).

<sup>22</sup> See *Fraud Hearings*, *supra* note 8, at 220-22. For example, the Commission estimated that International Diamond did over \$150,000,000 in business annually. *Id.* at 220. It was able to settle its FTC case for \$6.7 million. *Id.*

<sup>23</sup> See *Fraud Hearings*, *supra* note 8, at 140-41 (prepared statement of Richard F. Miklic, Supervising U.S. Probation Officer, S.D. Fla.).

<sup>24</sup> See *FTC Review (1977-84): Report Prepared by a Member of the FTC [Michael Pertschuk] together with Comments from Other Members of the Comm'n for the Use of the Subcomm. on Energy and Commerce*, 98th Cong., 2d Sess. 7 (1984).

<sup>25</sup> 748 F.2d 1431 (11th Cir. 1984).

<sup>26</sup> See *Fraud Hearings*, *supra* note 8, at 222.

<sup>27</sup> *Id.* The company had \$12 million in assets and went into liquidation. See *id.*

junctions fill a void in law enforcement against fraud. The Commission's new jurisdiction extends to any practices in or affecting consumers,<sup>28</sup> whereas other federal civil agencies which combat fraud have narrow jurisdictional limitations. For instance, the Securities and Exchange Commission (the "SEC") can only regulate securities and related industries<sup>29</sup> and the Commodities Futures Trading Commission (the "CFTC") can only regulate commodities futures contracts and related investments.<sup>30</sup> Most of the Federal Trade Commission's cases to date have been outside both the SEC's and CFTC's jurisdiction.

Through permanent injunctions, the Commission can also reach cases beyond criminal prosecution. Although criminal prosecution carries the threat of much harsher penalties, criminal fraud is very difficult to prove. Criminal prosecutors must prove, beyond a reasonable doubt, the accused's actual knowledge of the falsehood or his reckless indifference to the truth.<sup>31</sup> The Commission has a lower burden of proof, and, as will be developed later, should have to prove less to secure an injunction and a monetary redress judgment.<sup>32</sup> Furthermore, the Commission can secure preliminary injunctions to stop practices during the pendency of its actions.

Section 13(b) actions are a very promising consumer protection enforcement tool.<sup>33</sup> By indirectly authorizing potentially broad

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<sup>28</sup> FTC Act, § 5, 15 U.S.C. § 45 (1982 & Supp. III 1985).

<sup>29</sup> Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77mm (1982 & Supp. III 1985)). Other statutes enforced by the SEC include: Securities and Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78kk (1982 & Supp. III 1985)); Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636 (codified as amended at 15 U.S.C. §§ 78aaa-78lll (1982)); Public Utility Holding Company Act of 1935, ch. 687, tit. I, 49 Stat. 803 (codified as amended at 15 U.S.C. §§ 79 to 79z-6 (1982 & Supp. III 1985)); Investment Advisers Act of 1940, ch. 686, tit. II, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80a-1 to 80b-21 (1982 & Supp. III 1985)).

<sup>30</sup> Commodities Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified as amended at 7 U.S.C. §§ 1-23 (1982 & Supp. III 1985)).

<sup>31</sup> See *United States v. MacKay*, 491 F.2d 616, 623 (10th Cir. 1973), *cert. denied*, 416 U.S. 942 (1974).

<sup>32</sup> See *infra* notes 221-26 and accompanying text.

<sup>33</sup> In fiscal 1982, the Commission filed two section 13(b) enforcement actions. *FTC v. Hosiery Corp. of Am.*, No. 81-4237 (E.D. Pa. filed Sept. 28, 1982); *FTC v. International Diamond Corp.*, No. 82-0878 WAI (JSB) (N.D. Cal. filed Mar. 4, 1982). See ANNUAL REPORT 9, 12 (1982). Since then the Commission has filed over forty such actions. *FTC v. American Nat'l Cellular, Inc.*, 810 F.2d 1511 (9th Cir. 1987); *FTC v. Brown & Williamson Tobacco Corp.*, 778 F.2d 35 (D.C. Cir. 1985); *FTC v. Evans Prods. Co.*, 775 F.2d 1084 (9th Cir. 1985); *United States v. Hopkins Dodge Sales*, No. 3-85-1859, slip op. (D. Minn. filed Nov. 18, 1985, decided June 15, 1987); *FTC v. Standard Fin. Management Corp.*, 52 Antitrust & Trade Reg. Rep. (BNA) 337 (D. Mass. consent decree filed Feb. 19, 1987); *FTC v. Engage-A-*

remedies, though, section 13(b) leaves open many questions about the scope of the remedy. Section 13(b) states only that the situation must be a "proper case" and that the Commission must make "proper proof," but defines neither term.

Defining "proper cases" requires identifying those situations in which the courts can act effectively as the decisionmaker. Section 5 of the FTC Act declares illegal all unfair and deceptive acts or practices in or affecting commerce.<sup>34</sup> In applying this language, the Commission has argued that courts can effectively act in any case in which a "clear" violation exists. A clear violation, according to the Commission, is any violation of either a trade regulation rule or a statute enforced by the Commission other than the FTC Act,

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Car People, Inc., No. 86-3758, slip op. (D.N.J. 1986); FTC v. Adler, 51 Antitrust & Trade Reg. Rep. (BNA) 822 (D.R.I. stipulated final order filed Dec. 2, 1986); FTC v. Rare Coin Galleries of Am., No. 86-2683-C (D. Mass. filed Sept. 16, 1986); United States v. KRSS Dev. Corp., No. 85C-9888 (E.D. Ill. consent decree filed Sept. 10, 1986); FTC v. Solar Mich., Inc., No. 86-CV-40368-FL (E.D. Mich. filed Aug. 11, 1986); United States v. North Am. Office Sys., No. CA-386185-OG (N.D. Tex. filed July 17, 1986); United States v. Rocky Mountain Circulation, No. 86-798 (D. Colo. filed Apr. 23, 1986); FTC v. Solar Am., Inc., No. C-1-86-0291 (S.D. Ohio filed Mar. 28, 1986); FTC v. Music Library Assoc., No. 86-1145 (C.D. Cal. filed Feb. 21, 1986); United States v. Thermo Prods. Co., No. W-86CA007 (W.D. Tex. filed Jan. 15, 1986); FTC v. Kitco of Nev., Inc., 612 F. Supp. 1282 (D. Minn. 1985); United States v. Technical Communications, Inc., No. 85-137-CIV-7 (E.D.N.C. filed Dec. 20, 1985); United States v. Walser Motors, No. 3-85-1898 (D. Minn. filed Dec. 4, 1985); FTC v. Freeway Dodge, Inc., No. 4-85-1573 (D. Minn. filed Nov. 18, 1985); FTC v. The Cellular Corp., No. 85-8231WHO (N.D. Cal. filed Nov. 10, 1985); United States v. Allied Fin. Co., No. 3-85-1771R (N.D. Tex. consent decree filed Sept. 30, 1985); United States v. Fidelity Acceptance Corp., No. 3-85-1588 (D. Minn. consent decree filed Sept. 30, 1985); United States v. Landmark Fin. Serv. Inc., 612 F. Supp. 623 (D. Md. 1985) (consent decree filed Dec. 9, 1986); United States v. Hooker Homes, Inc., No. C85-4239A, slip op. (D. Ga. 1985) (consent decree filed Aug. 25, 1986); United States v. Intra-Medic Formulations, Inc., No. 85-2819 (S.D. Fla. filed Aug. 11, 1985); United States v. Royco Auto. Parts, Inc., No. 83-1208-CIV-J-12, slip op. (M.D. Fla. July 17, 1985); United States v. C.D. Control Technology, No. CV-8502437 (E.D.N.Y. filed June 28, 1985); United States v. Nash/Phillips Copus, Inc., No. 85-2038 (W.D. Tex. consent decree filed June 24, 1985); FTC v. Kaplan, No. LV 85161 (D. Nev. filed Mar. 6, 1985); FTC v. Nationwide Mortgage Corp., No. 85-0976 (D.D.C. filed Mar. 26, 1985); FTC v. Kelley, No. 85-0736-5 (D. Mass. filed Feb. 19, 1985); FTC v. Furman, No. 84-0803-A, slip op. (E.D. Va. Jan. 30, 1985); FTC v. Jones, No. 85-0189 (C.D. Cal. filed Jan. 9, 1985); United States v. Sheldon Friedlich Mktg., No. 85-130 (S.D.N.Y. filed Jan. 7, 1985); FTC v. Alaska Land Leasing, Inc., No. 84-5416 AWT (Px) (C.D. Cal. July 23, 1984); FTC v. Trans-Alaska Energy Corp., 52 Antitrust & Trade Reg. Rep. (BNA) 269 (C.D. Cal. filed Mar. 27, 1984); FTC v. Kimberly Int'l Gem Corp., 49 Antitrust & Trade Reg. Rep. (BNA) 439 (C.D. Cal. filed Aug. 15, 1983); FTC v. U.S. Oil & Gas Corp., No. 83-3589 CIV-WMH, slip op. (S.D. Fla. 1983), *aff'd per curiam*, 748 F.2d 1431 (11th Cir. 1984); FTC v. Leland Indus., No. 83-3589 CBM (Px) (C.D. Cal. filed June 3, 1983); FTC v. J & R Mktg. Corp., 48 Antitrust & Trade Reg. Rep. (BNA) 881 (S.D. Fla. May 18, 1983); FTC v. First Petroleum Corp. of Am., No. 82-2744 CIV-WMH (S.D. Fla. filed Dec. 21, 1982).

<sup>34</sup> FTC Act, § 5, 15 U.S.C. § 45 (1982 & Supp. III 1985).



as well as any practice previously declared unfair or deceptive by the Commission in an administrative adjudication.<sup>35</sup>

The clear violation standard, however, does not work well because courts cannot rely on the Commission's adjudicative decisions. In non-rule violation cases, the Commission has always relied on its congressional mantle of administrative expertise to define the meaning of unfair and deceptive practices.<sup>36</sup> Because the Commission's decisions are based on their own expertise, they give courts no guidance beyond the specific practices declared illegal. The section 13(b) cases to date indicate that courts do not rely on Commission precedents, but decide for themselves whether practices are unfair or deceptive. These cases also indicate that courts do not interpret section 5 of the FTC Act consistently with either the Commission or each other.

These inconsistent interpretations of section 5 threaten the Commission's policymaking role. The Commission has used the broad "unfair and deceptive practice" language of section 5 to define and redefine the limits of fair business practices. In doing so, the Commission has often declared certain practices illegal which had previously been considered proper.<sup>37</sup> Extensive judicial interpretations of section 5 may create conflicting lines of authority on the meaning of section 5 unfairness and deception that may inhibit the Commission's ability to maintain the flexible meaning of section 5.<sup>38</sup>

In addition, courts have awarded redress judgments and have issued injunctions enforceable through criminal contempt proceedings to enforce their judgments. The Commission generally can enforce its rulings only through cease and desist orders. These orders cannot impose liability for a past violation of section 5 and are only enforceable through civil penalty proceedings. The stronger

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<sup>35</sup> See *infra* notes 133-35 and accompanying text.

<sup>36</sup> See *infra* notes 136-45 and accompanying text.

<sup>37</sup> See *infra* notes 137-42 and accompanying text (discussing development of the prior substantiation doctrine).

<sup>38</sup> The concerns here are similar to the policies behind the doctrine of primary jurisdiction; that when an agency and the courts have concurrent jurisdiction over a private claim, the agency should use its expertise to interpret its statute before the courts do. See generally 4 K. DAVIS, *ADMINISTRATIVE LAW TREATISE*, §§ 22:1-22:11, at 81-121 (2d ed. 1983). The purpose of primary jurisdiction is to allow uniformity in the regulatory scheme and to allow expert regulators to resolve technical questions within their area of expertise. *Id.* Similarly, the concern here is to circumscribe judicial interpretation of the administrative standard, section 5, to permit the Commission to maintain a consistent, single interpretation of that standard. See *id.*

judicial remedies may not be necessary or appropriate against some unfairness and deception. Often, it is very difficult to tell whether the complained of practices are harmful, or whether they are actually the fair result of a properly operating market.<sup>39</sup> Congress authorized the Commission to make these close decisions. The generalist courts, in attempting to decide close cases, may actually harm consumers by inhibiting efficient, competitive business practices.

Thus, section 13(b) actions should be formally limited to a particularized set of proper cases that the courts are competent to consider. This Article identifies those situations in which the courts should be competent to find practices illegal under section 5. The Article then proposes a workable legal standard that encompasses these proper cases without including cases for which Commission proceedings would be more appropriate. In order to find a given situation to be a proper case, the Commission should have to establish either a trade regulation rule violation, violation of a statute other than the FTC Act, or a misrepresentation of material fact. This standard is superior to the Commission's clear violation standard because it shifts the court's focus away from the unfair or deceptive language of section 5 to a standard courts are familiar with and competent to handle, thereby eliminating potentially conflicting judicial interpretations of section 5. The proposed standard would provide the same relief actually secured by the Commission in recent cases, but would avoid judicial interpretations of section 5 that are inconsistent with each other and with the Commission's interpretations.

This Article will then address the proper proof that the Commission should have to establish in order to secure injunctions and redress awards, as well as the proper measure of recovery for redress awards. Since prospective injunctions have the same corrective effect as cease and desist orders, courts should issue injunctions in any proper case. The overriding goal for redress awards should be deterrence.<sup>40</sup> Courts should adopt standards for the proper proof and the measure of recovery that provide for maximum deterrent effect. This Article evaluates the extent to which the courts are currently adopting standards that will provide deterrence and concludes that in order to provide meaningful deter-

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<sup>39</sup> See *infra* notes 122-25 and accompanying text.

<sup>40</sup> See *infra* notes 221-26 and accompanying text.

rence, the Commission should be authorized to seek civil penalties, in addition to equitable redress, against truly fraudulent actors.

## II. BACKGROUND

The heart of the Commission's consumer protection law is section 5 of the FTC Act. Section 5 declares illegal, "unfair or deceptive acts or practices in or affecting commerce."<sup>41</sup> Congress drafted section 5 as the centerpiece of an administrative enforcement system designed to identify potentially harmful practices and to stop them in their incipiency. The Commission's goal was to correct unlawful practices, not to punish wrongdoers. However, in the 1970's, Congress wanted more. It wanted the Commission to deter dishonest practices. In doing so, Congress wanted to maintain a flexible administrative standard. Deterrence, however, requires a relatively fixed standard that will give wrongdoers notice that their contemplated acts will violate the law. Congress resolved the conflict between flexibility and deterrence in many of the reforms of the 1970's. With section 13(b), however, Congress cryptically limited actions to "proper cases," with no further guidance.

### A. *The Desire for an Expert Commission*

#### 1. The 1914 Act

Congress originally adopted the administrative enforcement of laws against unfair business practices because of the failures it saw in the judicial enforcement of the Sherman Antitrust Act.<sup>42</sup> The Sherman Act prohibited "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade."<sup>43</sup> The Supreme Court adopted a "Rule of Reason," which held that not all restraints of trade were prohibited, but only unreasonable ones.<sup>44</sup> In 1911, the Cummins Report criticized the Rule of Reason as vague and uncertain and charged the Court with garnering legis-

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<sup>41</sup> FTC Act, § 5, 15 U.S.C. § 45(a)(1) (1982). The applicability of section 13(b) actions to unfair methods of competition is beyond the scope of this Article.

<sup>42</sup> See Act of July 2, 1890 (Sherman Act), ch. 647, 26 Stat. 209 (codified as amended at 15 U.S.C. §§ 1-11 (1982)).

<sup>43</sup> *Id.* § 1.

<sup>44</sup> See *Standard Oil Co. v. United States*, 221 U.S. 1 (1911); *United States v. American Tobacco Co.*, 221 U.S. 106 (1911). For a detailed legislative history of the 1914 FTC Act, see G. HENDERSON, *THE FEDERAL TRADE COMMISSION, A STUDY IN ADMINISTRATIVE LAW AND PROCEDURE* (1924); 5 E. KINTNER, *THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES* (1982).

lative authority to itself.<sup>45</sup> The legitimacy of a business practice now turned on "the economic standard which the individual members of the court may happen to approve."<sup>46</sup> The report concluded that such vague standards created only uncertainty and judicial delay,<sup>47</sup> and recommended the establishment of an expert administrative body to aid in trade law enforcement.<sup>48</sup>

In 1914, all three major political parties called for the establishment of an expert, administrative trade commission<sup>49</sup> to effectively regulate unfair trade practices.<sup>50</sup> Over time, it was expected that this expert body would build up a coherent body of trade law that would "be accepted and will constitute our code of business morals."<sup>51</sup>

The Commission was created by Congress and section 5 of the 1914 Act declared "unfair methods of competition" illegal, and gave the Commission the authority to issue orders to cease and desist such practices.<sup>52</sup> The conference report stated that an expert

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<sup>45</sup> S. REP. NO. 1326, 62d Cong., 3d Sess. 10-11 (1913) [hereinafter Cummins Report]. The Cummins Report also criticized *Hopkins v. United States*, 171 U.S. 578 (1898), and *United States v. E.C. Knight Co.*, 156 U.S. 1 (1894), for requiring the government to show "direct" interference with commerce before establishing a Sherman Act violation. The report claimed courts were not competent to make such decisions:

It is obvious that the opinion of any given man in any given case upon this question, whether he be judge or not, must depend largely, not upon his learning in the law but upon his training and bent in the economy of commerce. The result has been, and necessarily will be, that the law officer of the Government before he institutes a prosecution must determine whether the restraint is direct and immediate, and the court in order to decide the issue must employ the functions of the legislator rather than lawyer.

Cummins Report, *supra*, at 5.

<sup>46</sup> *Id.* at 10.

<sup>47</sup> *Id.* at 12-13.

<sup>48</sup> *Id.*

<sup>49</sup> The 1912 Republican and Progressive platforms both called for establishment of a trade commission. H.R. REP. NO. 533, 63d Cong., 2d Sess., pt. 2, at 2 (1914) (minority report). President Wilson also called for a trade commission. Address by President Woodrow Wilson Before a Joint Session of Congress on Additional Legislation for the Control of Trusts and Monopolies, H.R. Doc. No. 625, 63d Cong., 2d Sess. 5 (Jan. 20, 1914), *reprinted in* 51 CONG. REC. 1962-64, 1978-79 (1914).

<sup>50</sup> See Cummins Report, *supra* note 45, at 18-23 (separate statement of Sen. Newlands).

<sup>51</sup> 51 CONG. REC. 11,083 (1914) (remarks of Sen. Newlands). See S. REP. NO. 597, app., 63d Cong., 2d Sess. 21-22 (1914).

<sup>52</sup> FTC Act, § 5(b), 38 Stat. 717, 719 (codified as amended at 15 U.S.C. § 45(b) (1982)). Commission orders to enforce this general standard proscribed future conduct only; they did not impose penalties or liability for past acts, and initially the orders were not even self-enforcing. *Id.* The sponsors of the bill did not favor penalties for prior conduct. Senator Newlands described the Commission's role as "instructive rather than punitive, helpful

commission with such powers could isolate potentially harmful practices and stop them before they grew.<sup>53</sup> The Act intentionally omitted a definition of "unfair methods of competition," leaving it to the Commission to define. The Senate Committee report stated that it would be futile to attempt to list specific methods of unfair competition "after writing 20 of them into the law it would be quite possible to invent others."<sup>54</sup> The conference report added that no one definition could cover every situation, stating that "[w]hether competition is unfair or not generally depends upon the surrounding circumstances of the particular case."<sup>55</sup> Congress wanted an expert commission to make those detailed judgments in particular cases.

Congress thus created an expert Commission that would correct business practices harmful to the public interest. The Commission would test business practices against the flexible standard of "unfair methods of competition." The Commission would not punish, but would only correct. In the process, the Commission would evolve standards for business practices that could change and grow with the times.

## 2. The Wheeler-Lea Amendment of 1938

The Wheeler-Lea Amendment of 1938 echoed the goal of the Act's original authors, to have an expert body apply a general standard in order to correct business practices. The Wheeler-Lea Amendment of 1938 added "unfair and deceptive acts and prac-

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rather than prejudicial." Representative Stevens, a member of the conference committee, later added that the Commission would "help by information, encouragement, admonition, advice, and, if necessary, restraint." 51 CONG. REC. 14,937 (1914).

Penalties were later added to this legislative scheme. Act of Mar. 21, 1938, ch. 49, § 5(l), 52 Stat. 111, 114 [hereinafter Wheeler-Lea Amendment of 1938]. This amendment added civil penalties of up to \$5,000 for violating cease and desist orders. The Trans-Alaska Pipeline Act of 1973, Pub. L. No. 93-153, tit. II, 87 Stat. 576, 591 (codified as amended at 15 U.S.C. § 45(l) (1982)) [hereinafter 1973 FTC Amendments], increased the maximum civil penalty to \$10,000.

<sup>53</sup> H.R. CONF. REP. NO. 1142, 63d Cong., 2d Sess. 19 (1914).

The most certain way to stop monopoly at the threshold is to prevent unfair competition. This can be best accomplished through the action of an administrative body of practical men thoroughly informed in regard to business, who will be able to apply the rule enacted by Congress to particular business situations so as to eradicate evils with the least risk of interfering with legitimate business operations.

*Id.*

<sup>54</sup> S. REP. NO. 597, 63d Cong., 2d Sess. 13 (1914).

<sup>55</sup> H.R. CONF. REP. NO. 1142, 63d Cong., 2d Sess. 19 (1914).

tices" as section 5 violations.<sup>56</sup> Congress added this language to overturn a restrictive Supreme Court interpretation.<sup>57</sup> Throughout the 1920's the Commission had repeatedly found deceptive advertising to be an unfair method of competition.<sup>58</sup> In 1931, the Supreme Court interpreted unfair methods of competition to mean that the Commission could restrain only those practices that injured competitors.<sup>59</sup> The Commission had to prove injury to competitors to establish a violation. If no competitors were injured, even fraud would not violate the Act. Congress added the language "unfair or deceptive acts and practices" to remove this evidentiary burden.<sup>60</sup> As with the 1914 Act, Congress made no attempt to define the newly declared illegal unfair and deceptive acts or practices. Congress intended that the Commission have the same flexibility in interpreting unfair and deceptive acts or practices as it did in interpreting unfair methods of competition. Senator Wheeler stated, "[t]his legislation is designed to give the Federal Trade Commission jurisdiction over unfair acts and practices for consumer protection to the same extent that it now has jurisdiction over unfair methods of competition for the protection of competitors."<sup>61</sup>

The amendment's sponsors also rejected attempts to punish businessmen for past acts as evidenced by the Senate report which described the Commission's authority as "preventive and cooperative rather than penal."<sup>62</sup> Representative Lea stated in floor de-

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<sup>56</sup> Wheeler-Lea Amendment of 1938, § 3, 52 Stat. at 111-12 (amending FTC Act, § 5(a)). For a detailed legislative history of the Wheeler-Lea Amendment, see 6 E. KINTNER, *supra* note 44, at 4807-4946 (1983).

<sup>57</sup> See Handler, *The Jurisdiction of the Federal Trade Commission Over False Advertising*, 31 COLUM. L. REV. 527, 534-35 (1931).

<sup>58</sup> See, e.g., *FTC v. Winsted Hosiery Co.*, 258 U.S. 483, 493 (1922) (misrepresentation and misdescription are unfair methods of competition).

<sup>59</sup> *FTC v. Raladam Co.*, 283 U.S. 643 (1931); see Handler, *supra* note 57 (analysis of *Raladam's* limitation of FTC jurisdiction).

<sup>60</sup> See Craswell, *The Identification of Unfair Acts and Practices by the Federal Trade Commission*, 1981 WIS. L. REV. 107, 111-12 [hereinafter Craswell, *Unfair Acts*].

After the amendment, section 5 read, "[u]nfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful." Wheeler-Lea Amendment of 1938, ch. 49, § 3, 52 Stat. 111, 111-12. In 1975, the "in commerce" language was changed to "in or affecting commerce." Federal Trade Commission Improvement Act of 1975, Pub. L. No. 93-637, tit. II, § 201, 88 Stat. 2183, 2193 (1975) (codified as amended at 15 U.S.C. § 45(b) (1982)) [hereinafter FTC Improvement Act of 1975].

<sup>61</sup> 83 CONG. REC. 3256 (1938) (remarks of Sen. Wheeler). See Craswell, *Unfair Acts*, *supra* note 60, at 111-12.

<sup>62</sup> S. REP. NO. 221, 75th Cong., 1st Sess. 1 (1937). A separate part of the Wheeler-Lea

bates that all the Commission had to do was to point out improper practices and businesses would correct them:

The great majority of people who advertise want to do the right thing, and if the Government points out to them where they are making a mistake and are in violation of the law, they are willing to conform to the law. The man with good intentions should not be penalized before he has had a chance to correct his mistake.<sup>63</sup>

In both the 1914 Act and the Wheeler-Lea Amendment of 1938, Congress wanted an expert Commission that would correct business practices harmful to the public interest without imposing liability for past acts or providing remedies for private injury. The Commission would point the way and businessmen would follow.

### 3. The Commission as Congress' Experts

The Commission has acted as Congress' independent body of business experts since 1914. It has used the broad language of section 5 to fashion and refashion its concept of the parameters of fair and honest business practices. The Commission has developed separate standards for commercial deception and unfairness.<sup>64</sup> A number of guides have been published by the Commission stating its opinion on how businesses in particular industries should oper-

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Amendment gave the Commission extensive authority to stop false advertising of food and drugs, including authority to seek preliminary injunctions in anticipation of administrative proceedings, and, in some cases, to seek criminal penalties. See Wheeler-Lea Amendment of 1938, ch. 49, §§ 12(a)-14(a), 52 Stat. at 114-15. See generally 6 E. KINTNER, *FEDERAL ANTI-TRUST LAW* § 43.17 (1986). The conference committee considered giving the Commission similar authority for all section 5 violations, but rejected that as too severe. Senator Wheeler stated that extending the penalties:

would bring down on our heads every businessman in the United States, who would probably say to us, "what are you going to do? You are not going to give us a chance. You are going to make it possible for someone to get an injunction against us. You are going to enable one to file a complaint charging us with a criminal offense and you should not do that."

83 CONG. REC. 3293 (Mar. 14, 1938) (remarks of Sen. Wheeler).

<sup>63</sup> 83 CONG. REC. 392 (1938) (remarks of Rep. Lea).

<sup>64</sup> For a historical perspective on how the Commission's unfairness and deception standards have evolved over time, compare the following commentators' analyses of section 5: Averitt, *The Meaning of "Unfair Acts or Practices" in Section 5 of the Federal Trade Commission Act*, 70 GEO. L.J. 225, 239-67 (1981); Craswell, *Unfair Acts*, *supra* note 60, at 111-13; Fraser, *The Federal Trade Commission Enforcement Against Deceptive Advertising*, 1985 ANN. SURV. AM. L. 537; Millstein, *The Federal Trade Commission and False Advertising*, 64 COLUM. L. REV. 439, 457-92 (1964); Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 HARV. L. REV. 661, 675-92 (1977); Note, *Deceptive Advertising*, 80 HARV. L. REV. 1005, 1038-62 (1967).

ate.<sup>65</sup> The Commission has also issued advisory opinions on the appropriateness of proposed practices.<sup>66</sup> In the mid-1960's, the Commission began promulgating trade regulation rules which had the force of law, and which precisely prescribed proper practices for entire industries.<sup>67</sup> The Commission could revise standards for business practices because it alone decided what was unfair or deceptive under section 5. In the words of the Supreme Court, the Commission, "like a court of equity," measured "a practice against the elusive, but congressionally mandated standard of fairness."<sup>68</sup>

The Commission was able to maintain flexibility in its standards because it enforced its decisions, including its trade regulation rules, through cease and desist orders.<sup>69</sup> The order only pro-

<sup>65</sup> See 16 C.F.R. §§ 228-59 (1987).

<sup>66</sup> See, e.g., ANNUAL REPORT OF THE FEDERAL TRADE COMMISSION 61 (1983).

<sup>67</sup> The Commission developed rulemaking in the 1960's based on FTC Act, § 6(g), 38 Stat. at 722 (Commission shall make "rules and regulations for the purpose of carrying out . . . this Act") (codified as amended at 15 U.S.C. § 46(g) (1982)). See *National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 675 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974); Auerbach, *The Federal Trade Commission Internal Organization and Procedure*, 48 MINN. L. REV. 383, 455-61 (1964); Baum & Baker, *Enforcement, Voluntary Compliance and the Federal Trade Commission*, 38 IND. L.J. 322, 351-45 (1963). The FTC Improvement Act of 1975 specifically authorized trade regulation rules. See FTC Improvements Act of 1975, § 202 (codified as amended at 15 U.S.C. § 57(a)(1)(b) (1982 & Supp. III 1985)). See generally Kintner & Smith, *The Emergence of the Federal Trade Commission as a Formidable Consumer Protection Agency*, 26 MERCER L. REV. 651, 669-79 (1975); Note, *The Federal Trade Commission Today: The New Improved Improvements Act*, 3 HASTINGS CONST. L.Q. 849, 851-53 (1976); Note, *Administrative Law—Magnuson-Moss Warranty-Federal Trade Commission Improvement Act—The FTC Can Obtain Equitable Relief for Deceptive Trade Practices*, 53 TEX. L. REV. 831, 831-32 (1975).

<sup>68</sup> *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972).

<sup>69</sup> FTC Act, § 5(b), 15 U.S.C. § 45(b) (1982). Section 5(b) provides in pertinent part: Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in or affecting commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. . . . If upon such hearing the Commission shall be of the opinion that the method of competition or the act or practice in question is prohibited by this subchapter, it shall make a report in writing in which it shall state its findings as to the facts and shall issue and cause to be served on such person, partnership, or corporation an order requiring such person, partnership, or corporation to cease and desist from using such method of competition or such act or practice.

*Id.*

Cease and desist orders were the only enforcement tool in the original FTC Act. The Commission later developed rulemaking based on section 6(g) of the FTC Act. See *supra*



scribed future conduct; the cease and desist orders imposed no liability for past acts and provided no remedy for consumers injured by the unfair or deceptive practices.<sup>70</sup> Thus, courts could defer to the Commission when it declared illegal a practice previously considered proper because the ruling threatened no unfair surprise. The order only had a prospective, corrective effect. As many have said, the order in effect said, "go and sin no more."<sup>71</sup>

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note 67. It was not until the passage of FTC amendments attached to the Trans-Alaska Pipeline Act of 1973, Pub. L. No. 93-153, tit. II, 87 Stat. 576 (1973), and the FTC Improvement Act of 1975, *supra* note 60, that the Commission gained the authority to seek additional tools to remedy past wrongs. See FTC Act, § 18, 15 U.S.C. § 57a (1982 & Supp. III 1985) (1975 Improvement Act specifically authorized trade regulation rules); *infra* notes 73-95 and accompanying text. See generally Halverson, *The Federal Trade Commission's Injunctive Powers Under the Alaskan Pipeline Amendments: An Analysis*, 69 NW. U.L. REV. 872 (1975) (discussing legislative history of Trans-Alaska Pipeline Act of 1973); Kintner & Smith, *supra* note 67, at 665-88 (discussing history and effect of Trans-Alaska Pipeline Act of 1973 and 1975 Improvement Act).

<sup>70</sup> The Commission in the 1970's attempted to expand its cease and desist orders by requiring respondents in certain cases to make restitution to injured customers, to publish advertising correcting previous deceptive advertising, and, in some cases, to confess in the advertising that their previous advertisements were deceptive. Corrective advertising has been upheld, but other sanctions designed to remedy past wrongs have not. See, e.g., *Warner-Lambert Co. v. FTC*, 562 F.2d 749, 762-63 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 950 (1978) (upholding corrective advertising, but striking confessional statement); *Heater v. FTC*, 503 F.2d 321, 323-24 (9th Cir. 1974) (overturning restitution order). See also Pitofsky, *supra* note 64, at 692-701; Thain, *Advertising Regulation: The Contemporary FTC Approach*, 1 FORDHAM URB. L.J. 349, 351-66 (1973); Note, *The Limits of FTC Power to Issue Consumer Protection Orders*, 40 GEO. WASH. L. REV. 496, 502-05, 513-25 (1972) [hereinafter Note, *The Limits of FTC Power*]; Note, *Corrective Advertising*, 85 HARV. L. REV. 477 (1971) [hereinafter Note, *Corrective Advertising*]. In his dissenting opinion in *FTC v. Gratz*, 253 U.S. 421 (1920), Justice Brandeis stated:

The [cease and desist] proceeding is not punitive. The complaint is not made with a view to subjecting the respondents to any form of punishment. It is not remedial. The complaint is not filed with a view to affording compensation for any injury alleged to have resulted from the matter charged, . . . The proceeding is strictly a preventive measure taken in the interest of the general public.

*Id.* at 432 (Brandeis, J., dissenting). But see Sebert, *Obtaining Monetary Redress for Consumers Through Action by the Federal Trade Commission*, 57 MINN. L. REV. 225, 228 (1972) (FTC may have power to grant refunds to individuals "who incurred losses as the result of the very actions that led to issuance of the cease and desist order").

The Commission no longer seeks redress in litigated cease and desist proceedings, but still obtains redress awards as a part of consent decrees. See, e.g., *Charles Weller*, 104 F.T.C. 1089, 1095 (1984) (\$60,000 paid for consumer redress).

<sup>71</sup> Many commentators have criticized cease and desist orders for being mere "slaps on the wrist." See REPORT OF THE ABA COMMISSION TO STUDY THE FEDERAL TRADE COMMISSION 62-63 (1969) [hereinafter ABA REPORT]; E. COX, R. FELLMETH & J. SCHULZ, "THE NADER REPORT" ON THE FEDERAL TRADE COMMISSION 90 (1969) [hereinafter NADER REPORT]; Pitofsky, *supra* note 64, at 692-93; see also *infra* notes 73-75 and accompanying text. One commentator, quoting former FTC Chairman Dixon, further criticized cease and desist orders because they affected only one company in the industry, leaving the rest free to continue

Congress, dissatisfied with the limited nature of cease and desist orders, amended the FTC Act in 1974 and 1975 to give the Commission stronger enforcement powers. Congress still wanted the Commission to evolve business standards,<sup>72</sup> but Congress now wanted the Commission to deter wrongdoing and punish wrongdoers, rather than just correct erring merchants.

### B. Congress' Call for Deterrence

The impetus for the 1974 and 1975 amendments to the FTC Act was the great condemnation of the Commission in the late 1960's. In separate, scathing reports, the American Bar Association and Ralph Nader's "Raiders" condemned the Commission for incompetence, mismanagement, inaction, and ineffective enforcement of the FTC Act.<sup>73</sup> The reports rejected the proposition that "all the Commission need do is point the way." They wanted stronger enforcement tools. Both reports criticized the limited effect of Commission cease and desist orders. The administrative proceedings took too long;<sup>74</sup> often the respondent had voluntarily

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deceptive practices. See Note, *supra* note 64, at 1083 & n.162. Section 13(b) actions may provide a stronger remedy than a "slap on the wrist," but they still only isolate one or a few members of an industry for enforcement.

<sup>72</sup> A large portion of the 1975 amendments specifically authorized the Commission to define the meaning of "unfair and deceptive" through state regulation rules. See FTC Improvement Act of 1975, *supra* note 60.

<sup>73</sup> ABA REPORT, *supra* note 71, at 36-54; NADER REPORT, *supra* note 71, at 39-95.

<sup>74</sup> Complaints about delays date back to the 1920's. See G. HENDERSON, *supra* note 44, at 86. The 1969 ABA Report on the Commission provided detailed statistics of delay. ABA REPORT, *supra* note 71, at 29-31. For other commentators discussing Commission delay, see Pitofsky, *supra* note 64, at 692-94; Note, *The Limits of FTC Power*, *supra* note 70, at 498-501; Note, *Corrective Advertising*, *supra* note 70, at 481-84. See also Baum & Baker, *supra* note 67, at 367-75; Weston, *Deceptive Advertising in the Federal Trade Commission: Decline of Caveat Emptor*, 24 FED. B.J. 548, 561-63 (1964) (Commission has used temporary cease and desist orders to cut down on delay); Note, *The Federal Trade Commission and Reform of the Administrative Process*, 62 COLUM. L. REV. 671, 685-700 (1962).

The classic case of delay in FTC proceedings is *Carter Products, Inc. v. FTC*, 268 F.2d 461 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959). It took the Commission sixteen years to force Carter Products to drop "Liver" from the name of its Little Pills. See Weston, *supra*, at 561; Note, *Corrective Advertising*, *supra* note 70, at 483.

Cases extending beyond a decade have not left the Commission. The Commission took ten years to issue cease and desist orders in the *Analgesic* cases. The appeals took another year. See, e.g., *Bristol-Myers Co.*, 102 F.T.C. 21 (1983), *aff'd*, 738 F.2d 554 (2d Cir. 1984), *cert. denied*, 469 U.S. 1189 (1985); *Sterling Drug, Inc.*, 102 F.T.C. 395 (1983), *aff'd*, 741 F.2d 1146 (9th Cir.), *cert. denied*, 470 U.S. 1084 (1984); *American Home Prods. Corp.*, 98 F.T.C. 136 (1981), *aff'd*, 695 F.2d 681 (3d Cir. 1982). The *Amrep* case took ten years from complaint to affirmance by the circuit court of appeals. See *Amrep Corp.*, 102 F.T.C. 1362 (1983), *aff'd*, 768 F.2d 1171 (10th Cir. 1985), *cert. denied*, 106 S. Ct. 1167 (1986).

changed practices long before the order issued; during the pendency of these proceedings respondents could continue the objectionable practices, thus having every incentive to delay proceedings as long as possible; and the orders, once issued, only prohibited future conduct without imposing any criminal or civil liability for past acts, and without providing any remedy for consumers injured by those acts.<sup>76</sup> Both reports urged Commission authorization to seek injunctions to stop practices during the pendency of Commission proceedings and to secure remedies for consumers injured by past acts.

In 1971, Senators Magnuson and Moss proposed Senate Bill S. 986,<sup>76</sup> the forerunner of the Magnuson-Moss Warranty, Federal Trade Commission Improvement Act of 1975. In this bill, the authors sought to give the Commission power to deter section 5 violations, not just to correct them. The authors also sought to enable the Commission to stop violations more quickly and to secure compensation for consumers injured by unfair and deceptive practices. The bill would have authorized the Commission to seek civil penalties against those knowingly committing unfair or deceptive practices,<sup>77</sup> and would have permitted the Commission, after issuing a cease and desist order against any unfair or deceptive practice, to seek monetary redress on behalf of consumers.<sup>78</sup>

The report accompanying S. 986 condemned the Commission's cease and desist orders as wholly inadequate since the orders did not deter unlawful practices because businessmen faced no liability for those past acts.<sup>79</sup> The only way to secure adequate deterrence, according to the report, was to impose sanctions for the first bad act, the one committed before the Commission acted.<sup>80</sup> Even the consumer redress provisions were designed to deter future violations. The report stated that:

[t]he Committee's intent in giving these remedial powers was (1) to reinforce the Commission's credibility in policing the marketplace by authorizing sanctions which could realistically be expected to inhibit unlawful business practices and (2) to enable the

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<sup>76</sup> ABA REPORT, *supra* note 71, at 62-64; NADER REPORT, *supra* note 71, at 90-95, 167-73.

<sup>78</sup> S. 986, 92d Cong., 2d Sess. (1971).

<sup>77</sup> *Id.* § 202.

<sup>78</sup> *Id.* § 203.

<sup>79</sup> S. REP. NO. 269, 92d Cong., 1st Sess. 3-6 (1971).

<sup>80</sup> *Id.* at 4-5.

Commission, where its investigation of an act or practice revealed damage to consumers, to utilize the results of that investigation for the benefit of the damaged parties.<sup>81</sup>

Opponents of the bill challenged the wisdom of imposing liability on businesses for acts committed before the Commission had divined whether those acts were unfair or deceptive.<sup>82</sup> Permitting the Commission to use such a flexible standard to impose liability for past acts created a serious risk of unfair surprise. Senator Cook argued that the Commission often "breaks new ground" and finds conduct previously considered proper to be unfair and deceptive.<sup>83</sup> Senator Cook feared that the proposal would create "a risk of potentially ruinous retroactive liability if the FTC breaks new ground in a cease and desist proceeding and finds that a course of conduct is 'unfair or deceptive' when it previously had been generally thought to be proper."<sup>84</sup> He also argued that reviewing courts would not sustain novel cease and desist orders because of the potential for retroactive liability, and stated "[t]he Commission may be hamstrung in expanding the list of unfair and deceptive practices." He concluded that the Commission's flexibility to "break new ground" was desirable and could only be maintained by limiting it to prospective relief.<sup>85</sup>

The Improvement Act that ultimately passed in 1975<sup>86</sup> tried to respond to Senator Cook's concerns. Congress attempted to deter truly bad actors without creating the threat of unfair surprise and without limiting the Commission's ability to control the meaning of the terms "unfair" or "deceptive." Congress did so by limiting the new remedies to situations where the Commission had, in some manner, already decided whether the acts violate section 5, and by adding intent requirements. Section 5(m) authorized the Commission to seek civil penalties against: (1) rule violations done "with actual knowledge or knowledge fairly implied on the basis of objective circumstances" that the acts violated the rule; and (2) practices which the Commission previously declared unfair and decep-

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<sup>81</sup> *Id.* at 24.

<sup>82</sup> 117 CONG. REC. 39,854-55 (1971) (remarks of Sen. Cook). *See generally id.* at 39,856 (remarks of Sen. Hruska); *id.* at 39,846 (remarks of Sen. Buckley).

<sup>83</sup> *Id.* at 39,854-55 (remarks of Sen. Cook).

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> Magnuson-Moss Warranty—Federal Trade Commission Improvement Act of 1975, Pub. L. No. 93-637, tit. II, 88 Stat. 2183, 2193 (1975).

tive in a cease and desist proceeding, and, which were done with actual knowledge that the acts were unfair or deceptive.<sup>87</sup> Similarly, section 19 authorized the Commission to seek monetary redress for consumers after the Commission issued cease and desist orders against: (1) any rule violation; or (2) any unfair and deceptive practices which a reasonable person would have known were dishonest or fraudulent.<sup>88</sup> Section 19 also prohibited exemplary or punitive damages.<sup>89</sup>

### C. *The Lack of Congressional Guidance on Section 13(b)*

Section 13(b) started as part of the bill that was the forerunner to the 1975 Improvement Act. The original 1971 proposal authorized the Commission only to seek temporary restraining orders and preliminary injunctions against entities committing or about to commit unfair or deceptive practices.<sup>90</sup> The preliminary injunction would dissolve in twenty days unless the Commission instituted administrative proceedings against the entities subject to the injunction. If so commenced, the injunction would remain in force until the Commission completed the administrative proceedings. The bill contained no authority to seek permanent injunctions. When reintroduced in 1973, the bill, now numbered S. 356, again contained no authority for permanent injunctions.<sup>91</sup> When S. 356 came out of committee, the proposed section 13(b) contained the additional proviso, "[p]rovided further that in proper cases the Commission may seek, and, after proper proof, the court may issue a permanent injunction."<sup>92</sup>

In July, 1973, within days after S. 356 was voted out of committee in the Senate, Senators Jackson and Magnuson essentially lifted the injunction provision from S. 356 and included it as part of an amendment to the Trans-Alaska Pipeline Act.<sup>93</sup> This amendment, unlike S. 356, authorized the Commission to seek injunctions against violations of any statute enforced by the Commission, not

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<sup>87</sup> FTC Act, § 5(m), 15 U.S.C. § 45(m) (1982).

<sup>88</sup> FTC Act, § 19, 15 U.S.C. § 57b (1982).

<sup>89</sup> *Id.* Section 19 also stated that its remedies did not limit remedies under any other section of the FTC Act. FTC Act, § 19, 15 U.S.C. § 57b (1982).

<sup>90</sup> S. 986, 92d Cong., 2d Sess. § 208 (1971).

<sup>91</sup> S. 356, 93d Cong., 1st Sess. § 210 (1973), reported in S. REP. NO. 151, 93d Cong., 1st Sess. (1973).

<sup>92</sup> *Id.*

<sup>93</sup> 1973 FTC Amendments, § 408, 87 Stat. 598 (amending FTC Act, §§ 5(l), 6 and 13; and adding § 5(m)).

just against unfair or deceptive practices. Facing the emergency created by the Arab oil embargo, Congress passed the Trans-Alaska Pipeline Act with the FTC amendments intact.<sup>94</sup>

Unlike sections 19 and 5(m), Congress did not carefully limit section 13(b)'s application to avoid judicial decisions that might cause unfair surprise or limit the Commission's control of the meaning of unfair and deceptive practices. Neither the statute's "proper case" and "proper proof" language, nor the section's legislative history place any meaningful limits on section 13(b).<sup>95</sup> Yet, some limitations on 13(b) actions were necessary. Congress still wanted the Commission to develop Senator Newlands' body of trade law; the goal of deterrence was in addition to, not in place of, the goals of the 1914 and 1938 Acts. That is why Congress so carefully circumscribed the scope of sections 19 and 5(m). The scope of

<sup>94</sup> See 6 E. KINTNER, *supra* note 44, at 4951-52.

<sup>95</sup> The sparse legislative history on section 13(b) reveals little about the scope of the Commission's permanent injunction authority. The Senate Report accompanying S. 356 gives the only significant legislative history of this clause.

Provision is also made in section [13(b)] hearing, for a court to grant a permanent injunction. This will allow the Commission to seek a permanent injunction when a court is reluctant to grant a temporary injunction because it cannot be assured of a [sic] early hearing on the merits. Since a permanent injunction could only be granted after such a hearing, this will assure the court of the ability to set a definite hearing date. Furthermore, the Commission will have the ability, in the routine fraud case, to merely seek a permanent injunction in those situations in which it does not desire to further expand upon the prohibitions of the Federal Trade Commission Act through the issuance of a cease-and-desist order. Commission resources will be better utilized, and cases can be disposed of more efficiently.

S. REP. NO. 151, 93d Cong., 1st Sess. 30-31 (1973).

This paragraph implies that the Committee added the second proviso to address concerns that courts might refuse to issue preliminary relief that could last indefinitely, particularly when they would have no way of forcing a hearing on the merits. Rather than granting the Commission a separate weapon against unfair and deceptive practices, the proviso gives the courts a tool to force the Commission to complete its proceedings; if the Commission takes too long, the court can take over the entire proceeding by ordering a hearing on the merits.

The reference to "routine fraud" later in the paragraph, though, authorizes the Commission to seek permanent injunctions in a certain class of cases. The reference, however, is ambiguous at best. The sentence discussing "routine fraud" seems to equate "routine fraud" with "those situations in which it does not desire to further expand upon the prohibitions of the FTC Act." A proper case would then be any case in which the Commission had previously determined that the complained of acts violated section 5. Fraud, however, generally requires proof of intent, reliance, and injury; elements not required for proof of unfair or deceptive acts. See W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS §§ 107-10, at 740-70 (5th ed. 1984) [hereinafter PROSSER & KEETON]; 1 G. PALMER, THE LAW OF RESTITUTION § 3.1, at 228-32 (1978). See *infra* notes 227-35 and accompanying text. Thus, the "routine fraud" reference gives little guidance as to the scope of the proper cases. The legislative history is silent regarding proper proof.

section 13(b) actions must be similarly limited. Section 13(b) actions should not interfere with the Commission's ability to interpret the meaning of section 5. Section 13(b) actions, though, should reach the truly bad actor that Congress sought to deter. The next section seeks to define limits for section 13(b) actions that will strike an effective balance between these goals.

### III. THE PROPER CASE

#### A. *Economics of Advertising*

Economists and legal scholars have identified several market factors that should generally induce sellers not to deceive consumers; theoretically, these factors should protect consumers from significant injury.<sup>96</sup> This theory also identifies certain conditions that could result in unfair or deceptive practices.<sup>97</sup> By breaking down the causes of harmful practices in the market, the theory isolates those market conditions in which section 13(b) actions should be effective. These isolated market conditions in which section 13(b) actions would be effective can thus be used to develop the appropriate legal standard for the proper case.

This economic theory divides goods and services into three types: those for which consumers can readily discern their quality before purchasing them, called search goods (*e.g.*, clothing);<sup>98</sup> those for which consumers can discern their quality only after purchasing them and using them, called experience goods (*e.g.*, canned food);<sup>99</sup> and those for which consumers can never readily discern their quality, even after purchasing and using them, called credence goods (*e.g.*, automobile repair services).<sup>100</sup>

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<sup>96</sup> See R. POSNER, REGULATION OF ADVERTISING BY THE FTC 4-8 (1973) [hereinafter R. POSNER, FTC REGULATION]; Darby & Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J. L. & ECON. 67, 77-83 (1973); Jordan & Rubin, *An Economic Analysis of the Law of False Advertising*, 8 J. LEGAL STUD. 527, 530-31 (1979); Nelson, *Advertising as Information*, 82 J. POL. ECON. 729 (1974) [hereinafter Nelson, *Advertising*]; Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311 (1970) [hereinafter Nelson, *Information*]; Posner, *The Federal Trade Commission*, 37 U. CHI. L. REV. 47, 62-63 (1969).

<sup>97</sup> See Beales, Craswell & Salop, *The Efficient Regulation of Consumer Information*, 24 J. L. & ECON. 491, 501-13 (1981); Craswell, *Interpreting Deceptive Advertising*, 65 B.U.L. REV. 657, 722-25 (1985); Nelson, *Information*, *supra* note 96, at 315-17. See also Pitofsky, *supra* note 64, at 663 (impossible for consumers to have perfect information because there are "too many sellers offering too many products with a wide variety of characteristics").

<sup>98</sup> See Nelson, *Information*, *supra* note 96, at 312.

<sup>99</sup> *Id.*

<sup>100</sup> See Darby & Karni, *supra* note 96, at 68-69.

Sellers should have very little incentive to deceive consumers about search goods because consumers can discover the deception before the purchase.<sup>101</sup> Sellers could deceive consumers into purchasing experience goods the first time, but not the second. Thus, to the extent sellers rely on repeat business, they have no incentive to deceive consumers. Furthermore, consumers may gain information from the experience of others to reduce the possibility of injury even on the first purchase.<sup>102</sup> Intensive brand advertising of experience goods protects consumers further.<sup>103</sup> The brands with the best quality for the price will have the greatest incentive to invest in advertising to develop the reputation of that brand. This is so because they should gain the greatest amount of repeat sales for each advertising dollar. Once they have developed their reputation, these producers will also have the incentive to maintain that reputation through the quality of the product. Thus, name brands further protect consumers by providing a meaningful indicia of the quality of experience goods.

Credence goods present a threat of deception because consumers cannot easily discern the quality of the goods purchased.<sup>104</sup> Sellers could make several sales to consumers before the deception is discovered. Even in these cases, producers will have incentives not to deceive, but to provide the highest quality goods and services for the price.<sup>105</sup> High quality producers will build up a reputation as some consumers discern the quality of their goods. They should be able to charge a premium for this reputation. Since they can charge this premium, high quality firms should be most profitable. This competitive incentive should induce producers to increase profitability by increasing quality, not by deceiving consumers.<sup>106</sup>

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<sup>101</sup> See Nelson, *Advertising*, *supra* note 96, at 750.

<sup>102</sup> See Nelson, *Information*, *supra* note 96, at 321-23; Posner, *supra* note 96, at 62-63.

<sup>103</sup> See Nelson, *Advertising*, *supra* note 96, at 732-33, 749-51.

<sup>104</sup> See Darby & Karni, *supra* note 96, at 68-70.

<sup>105</sup> See *id.* at 77-83.

<sup>106</sup> Some proponents of this analysis argue that the Commission's consumer protection activities are largely unnecessary and probably harmful to consumers. Commission policies, developed either through cease and desist orders or rules, generally forced sellers to provide either additional information or a different mix of goods and services than the market indicated that consumers wanted. These additional goods, services, and information raised the costs to sellers and consumers. The benefits to consumers from additional information, goods, or services do not outweigh these costs because, according to this view, if they had, the market would have already provided it. See Darby & Karni, *supra* note 96, at 83-87; Posner, *supra* note 96, at 63-68. However, this argument ignores the fact that markets do



## B. Possible Sources of Deception and Unfairness

### 1. Fringe Experience and Credence Goods Markets

In a properly functioning market, consumer injury from any attempted seller deception or unfairness would be likely only in the sale of expensive, infrequently purchased experience goods or credence goods where the seller's profitability does not depend on repeat business.<sup>107</sup> In these situations, where consumers cannot discern the accuracy of statements before they buy, the threat of lost repeat business is not a check. Competitors, instead of challenging the accuracy of a firm's deceptive claim, can increase profitability by using even more outrageous tactics because consumers cannot discern who is telling the truth. Because of this competitive synergy, the harmful practices should be clear and extreme and the consumer injury should be direct and concrete.

Several of the Commission's section 13(b) cases fit squarely into this category. In *FTC v. U.S. Oil & Gas*,<sup>108</sup> for example, the defendants represented to customers that for an "investment" of as little as \$2,000, the customer would be virtually guaranteed of acquiring a ten-year federal oil and gas lease that could be sold within six months for at least \$25,000. They represented that former clients consistently received at least this return on their investments. In fact, less than one percent of customers acquired leases. Several of these defendants have been convicted of mail fraud for these activities.<sup>109</sup> In *FTC v. Kitco of Nevada, Inc.*,<sup>110</sup> defendants sold home business opportunities to manufacture form molded plastic items. The company represented that they would supply customers with regular work orders, pay cash for finished products and customers would have to do no selling. In fact, defendants sent customers few orders and generally did not pay customers for finished products. They instructed customers at one point to send finished products directly to their "warehouse,"

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not always function properly. See *infra* notes 117-28 and accompanying text.

<sup>107</sup> See Nelson, *Advertising*, *supra* note 96, at 730-31, 749-51; see also Nelson, *Information*, *supra* note 96, at 315-18, 327 (experienced goods sellers may have market power in some cases).

<sup>108</sup> No. 83-1702 CIV-WMH (S.D. Fla. filed July 7, 1983).

<sup>109</sup> *United States v. Wolfson*, No. 83-754-CR-Davis (S.D. Fla. convicted Apr. 11, 1985), *aff'd sub nom. United States v. Stockton*, No. 85-5139 (11th Cir. Feb. 6, 1987). See *Fraud Hearings*, *supra* note 8, at 196 (prepared statement of Stanley Marcus).

<sup>110</sup> 612 F. Supp. 1282 (D. Minn. 1985).

which turned out to be a company that recycled scrap plastic.<sup>111</sup> Profits in both of these cases depended primarily on first sales or subsequent sales made before the purchasers discovered the true value of the goods or services.

In such cases, the stronger section 13(b) remedies are proper. The generalist courts should easily be able to find that such outrageous practices violate section 5. The stronger judicial remedies are appropriate because the market provides no meaningful check on such practices. Inhibiting these practices should impose little countervailing costs on consumers because the practices serve no useful purpose. The successful actors in these markets do not sell the goods and services that the customers believe they are purchasing.<sup>112</sup>

## 2. Market Failures

In other situations, significant deception or unfairness may occur because of a market failure. Such failures may result from the cost of producing information and information market imperfections.<sup>113</sup> Sellers may often be reluctant to produce information for which consumers would be willing to pay. Producing information about a product is costly when one considers the costs of performing tests or surveys, but once produced it can benefit not only the seller producing the information, but also competing sellers of the same product. Thus, sellers producing information do not get all the benefits from their investments.<sup>114</sup> Because they cannot capture the full return on their investments, sellers may provide less useful information to consumers than that for which consumers would be willing to pay. Producers may also fail to dispute a competitor's deceptive claims, such as a mouthwash that helps prevent colds and flu, because the benefits from disputing the claims would go to all other competitors, yet the cost would be borne by the lone disputing competitor.<sup>115</sup> In addition, the deceptive claim itself may

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<sup>111</sup> *Id.* at 1293.

<sup>112</sup> Judge Posner would argue that, if the Commission does anything, it should concentrate its efforts in section 13(b) actions against the most egregious of frauds because market incentives effectively eliminate the risk of meaningful deception in the rest of the market. See R. POSNER, *FTC REGULATION*, *supra* note 96, at 32; Posner, *supra* note 96, at 76-77 (arguing that "hard core" fraud would be unaffected by cease and desist proceedings).

<sup>113</sup> See Beales, Craswell & Salop, *supra* note 97, at 501-13; Craswell, *supra* note 97, at 722-25; Pitofsky, *supra* note 64, at 663-67.

<sup>114</sup> See Beales, Craswell & Salop, *supra* note 97, at 503-05.

<sup>115</sup> Judge Posner argues that trade associations can act on behalf of all competitors in

benefit all competitors, since consumers may believe all mouthwashes help prevent colds and flu. Consequently, everyone's sales may increase, further reducing any market incentives to dispute the claims.<sup>116</sup>

Further, sellers' representations do not communicate the same idea to every listener or reader.<sup>117</sup> Every representation has the potential to deceive someone, but it may be too expensive for sellers to redraft representations to minimize this type of potential, though unintentional, deception. Even if the seller tried to avoid potential deception, the resulting representation may be so complicated by disclaimers and qualifications that it communicates no meaningful information.<sup>118</sup>

Aside from imperfections in information markets and the difficulty in communicating ideas, producers with market power may not have sufficient incentives to treat consumers honestly and fairly.<sup>119</sup> Regulations and other possible barriers to entry into a market may insulate producers from competitive forces. Our society has many direct regulatory barriers: licensing for doctors, lawyers, and other professionals; marketing orders for certain agricultural products; allocation of airport landing rights; and licensing of radio and television stations. We also have other regulations that raise costs, thereby indirectly inhibiting entry into markets: child labor laws, wage and hour laws, OSHA safety regulations, and environmental regulations. Some of these regulations, such as child labor laws, may serve very useful purposes; others may harm society, but it is politically impossible to eliminate them. Given that these barriers exist, and cannot or should not be removed, some producers have market power and may not have sufficient incentives to treat consumers honestly and fairly.

When information market imperfections cause unfairness or deception, section 13(b) permanent injunction actions will gener-

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this situation, thus avoiding the problem of one competitor or one consumer bearing the entire cost of challenging a deceptive claim. Posner, *supra* note 96, at 65-66. It seems odd to argue that private, collusive activity by competitors is likely to solve an information market failure. It is much more likely that these groups will inhibit, rather than promote competition. See Beales, Craswell & Salop, *supra* note 97, at 505 ("information intermediaries can achieve a high level of market power"). See generally FTC STAFF REPORT, STANDARDS AND CERTIFICATION (1978).

<sup>116</sup> See Beales, Craswell & Salop, *supra* note 97, at 507-09.

<sup>117</sup> See Craswell, *supra* note 97, at 668-81.

<sup>118</sup> See *id.*

<sup>119</sup> See Beales, Craswell & Salop, *supra* note 97, at 507-09.

ally be inappropriate because the distinctions are too subtle. In these situations, the market is not driving competitors toward more and more outrageous practices, rather, the market is providing some competitive incentives to avoid unfairness and deception, but not sufficient incentives to induce sellers to incur the costs to correct the deception or unfairness.<sup>120</sup> Under these conditions, differentiating between situations where the mix of goods and services accurately reflects the price that consumers are willing to pay and those situations where it does not, is a difficult task for generalist courts. Such subtle questions should be left to the Commission. The Commission, in reality, may be no better than the courts in drawing these distinctions, but Congress has declared them experts, and has instructed them to try.<sup>121</sup> By leaving these difficult questions to one decision making body, the resultant rulings should be more consistent. Moreover, the weaker cease and desist remedy presents less potential for inducing sellers to overact and to raise costs to consumers in efforts to overprotect them.

Cases in which unfairness and deception results from market power would not be proper cases for the generalist courts to decide. As with information market problems, it is often difficult to discern whether the objectionable practice is unfair or deceptive or merely a reflection of a properly functioning market. For example, the Commission's recent credit practices rule outlawed consumer loans secured by non-purchase money security interests on household belongings.<sup>122</sup> The Commission determined that consumers had no ability to bargain over security terms of consumer credit contracts,<sup>123</sup> and that the practice has no countervailing useful function. Used household furnishings have little resale value and provide creditors no real collateral. The only real purpose of this security interest is to harass debtors.<sup>124</sup>

Such security interests, however, may not have been attributable to the creditors' market power, but merely the result of a market efficiently allocating risk between borrower and lender. Borrowers may have preferred assuming this additional risk in

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<sup>120</sup> See Craswell, *supra* note 97, at 719-25.

<sup>121</sup> FTC Act, § 5, 15 U.S.C. § 45 (1982 & Supp. III 1985)); see *supra* notes 56-61 and accompanying text.

<sup>122</sup> See 16 C.F.R. § 444.2(a)(4) (1986).

<sup>123</sup> Credit Practices Rule: Statement of Basis and Purpose and Regulatory Analysis, 49 Fed. Reg. 7740, 7745 (1984).

<sup>124</sup> *Id.* at 7761-67.

exchange for lower interest rates. Only the person who defaulted would have paid the costs for accepting the added risk. Lenders may have preferred the arrangement because they could charge lower interest rates and more effectively impose the cost of defaults on the specific persons that defaulted. Without these security interests, lenders either have to find a new tool that effectively allocates the costs of defaults on defaulting borrowers only, or allocate the costs of defaults to all borrowers. Such cost increases would, in effect, cause consumers who do not default to subsidize those who do.

Most market power examples, except perhaps horizontal price fixing, are subject to equally plausible market perfecting or market failing hypotheses.<sup>125</sup> Such subtle questions, again, should be left to the Commission.

### C. *The Proposed Standard for Determining Proper Cases*

The correct legal standard should limit proper cases to those fringe experience goods and credence goods markets in which section 13(b) actions will be most effective. This writer proposes that such a proxy for non-rule violation cases would require the Commission to prove a misrepresentation of material fact. This is a basic element of many tort claims, including deceit and fraud in the inducement.<sup>126</sup> It is a standard that the courts find comfortable. Such misrepresentations would clearly be deceptive under section 5.<sup>127</sup> The standard should allow section 13(b) to reach most of the fringe credence and experience goods markets. These actors are the most likely to use the most outrageous claims about their goods or services. The standard would also eliminate from section 13(b) actions those subtler cases that require Commission expertise.

Admittedly, market imperfections may result in misrepresentations of material fact in markets other than those for fringe experience goods and credence goods. In those situations, however, courts should be competent to act. Enjoining any such misrepresentations would not require sophisticated analyses of market conditions because such misrepresentations serve no beneficial purpose. Therefore, any overinclusiveness in the standard poses no

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<sup>125</sup> See *supra* notes 119-24 and accompanying text.

<sup>126</sup> See D. DOBBS, *HANDBOOK ON THE LAW OF REMEDIES* § 9.1, at 591-93 (1973); PROSSER & KEETON, *supra* note 95, § 105, at 725-35; 1 G. PALMER, *supra* note 95, § 3.1, at 229.

<sup>127</sup> See *infra* notes 148-69 and accompanying text.

threat to the market.

This standard would not address two types of section 5 violations that may occur in markets for fringe credence goods or experience goods. First, it would not address the non-deceptive, but still unfair practice. However, this is more a theoretical problem. Given the competitive pressures in these markets, the successful competitor will use misrepresentations as well as unfair practices. To the extent some purely unfair practices exist, though, they should be left to the Commission. Unfairness, as the Commission has defined it, requires measuring whether a net benefit would result to all consumers and producers by requiring a change in the practice.<sup>128</sup> This measurement is so amorphous that only the Commission should apply it. The Commission has evidently recognized this point. It has not brought a section 13(b) case based purely on a claim of unfairness.

The standard also excludes cases in which the harmful practices are purely omissions of material fact by sellers. This is again more of a theoretical problem. Given the competitive incentives to deceive in these fringe markets, cases will almost always include misrepresentations as well as omissions and the proposed standard would cover these cases. At any rate, prudence suggests that any case based solely on omissions should be left to the Commission. An omission case requires the decisionmaker to consider whether a particular bit of information has to be told to consumers. Assessing what information consumers need to know and must receive from sellers before making decisions is again a subtle question that should be left to the Commission.<sup>129</sup> The threat of disrupting mar-

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<sup>128</sup> The current Commission unfairness standard tests whether the complained of practice causes: (1) substantial consumer injury, (2) which is not outweighed by any counter-vailing benefits that the practice produces for consumers or competitors and (3) which consumers cannot reasonably avoid. See *International Harvester Co.*, 104 F.T.C. 949, 1061 (1984); Letter from the Federal Trade Commission to Senators Wendell H. Ford & John C. Danforth 5-6 (Dec. 17, 1980), *reprinted as an appendix in International Harvester*, 104 F.T.C. at 1073-74 [hereinafter *Unfairness Letter*]. The standard, in effect, requires determining whether a change in practices will result in a net benefit to the general welfare. The standard has included other considerations. See *Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking*, 29 Fed. Reg. 8324, 8355 (July 2, 1964). But these other considerations have been downplayed. See *Unfairness Letter*, *supra* at 8-10, *reprinted in International Harvester*, 104 F.T.C. at 1074-75; *International Harvester*, 104 F.T.C. at 1061 n.43.

<sup>129</sup> See *International Harvester*, 104 F.T.C. at 1064-65; Beales, Craswell & Salop, *supra* note 97, at 522-23 ("legislators and regulators should be sensitive" to "real dangers" of increasing cost to consumers by mandated disclosures); Craswell, *Unfair Acts*, *supra* note 60, at 120-22; Gellhorn, *Trading Stamps*, S & H, and *the FTC's Unfairness Doctrine*, 1983

kets by inducing sellers to provide and charge consumers for information consumers do not want is too great. This is particularly true when most of these fringe cases will also involve misrepresentations thereby making them subject to the standard.

As a separate part of the standard, any trade regulation rule violation or violation of any statute enforced by the Commission other than the FTC Act, such as the Truth-in-Lending Act,<sup>130</sup> would be a proper case. Rule violations and violations of these other statutes are special cases because the Commission or Congress has specifically defined the proper conduct for businesses subject to these rules or statutes.<sup>131</sup> Courts can easily enforce these rules and statutes because of their specificity. The harsher penalties pose no threat of inducing overprotective reactions by producers because the rules and statutes expressly state the proper practices that will avoid such penalties.<sup>132</sup>

#### *D. The Commission's "Clear" Violation Standard*

The proposed standard limiting "proper cases" to fringe experience and credence goods, with the exceptions noted above, would work better than the Commission's current definition of a proper case. The Commission has asserted that any case is a proper case if the violation is "clear,"<sup>133</sup> and that the courts should rely on any prior Commission precedent on point, any trade regulation rule defining unfair or deceptive practices, or any other statute enforced by the Commission. The Ninth Circuit has apparently accepted this definition.<sup>134</sup> The Commission's standard and the proposed

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DUKE L.J. 903, 949-52.

<sup>130</sup> Pub. L. No. 90-321, tit. I, 82 Stat. 146 (codified as amended at 15 U.S.C. §§ 1601-71 (1982 & Supp. III 1985)). Other statutes enforced by the FTC include the Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (codified as amended at 15 U.S.C. §§ 1692-1692o (1982 & Supp. III 1985)); Magnuson-Moss Warranty Act, Pub. L. No. 93-637, tit. I, 88 Stat. 2183 (codified as amended at 15 U.S.C. §§ 2301-12 (1982)); Fair Packaging and Labeling Act, Pub. L. No. 89-755, 80 Stat. 1296 (codified as amended at 15 U.S.C. §§ 1451-61 (1982)); Wool Products Labeling Act of 1939, ch. 871, 54 Stat. 1128 (codified at 15 U.S.C. §§ 68-68j (1982 & Supp. III 1985)); Fur Products Labeling Act, ch. 298, 65 Stat. 175 (codified at 15 U.S.C. §§ 69-69j (1982)); Hobby Protection Act, Pub. L. No. 93-167, 87 Stat. 686 (codified at 15 U.S.C. §§ 2101-06 (1982)); and Equal Credit Opportunity Act, Pub. L. No. 93-495, tit. 5, 88 Stat. 1521 (codified as amended at 15 U.S.C. §§ 1691-1691f (1982)).

<sup>131</sup> See *supra* note 130.

<sup>132</sup> *Id.*

<sup>133</sup> *E.g.*, FTC v. International Diamond Corp., 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,705 (N.D. Cal. 1983) (magistrate's opinion).

<sup>134</sup> See, *e.g.*, FTC v. Evans Prods. Co., 775 F.2d 1084, 1086 (9th Cir. 1985) ("We accord

standard are in accord that rule violations and violations of other statutes enforced by the Commission should be proper cases. Case law indicates that the courts have no difficulty interpreting and enforcing either the rules or statutes other than the FTC Act.<sup>135</sup>

With regard to actions alleging just unfair or deceptive practices, however, the Commission's current standard is unworkable because the Commission's cease and desist decisions offer no meaningful guidance to the courts. The Commission's decisions often turn solely on the Commission's expert judgment. The Commission can decide all critical questions concerning how consumers might perceive and respond to challenged practices based solely on its own expertise. Essentially, all the Commission needs is proof that the representation or practice occurred.<sup>136</sup> Thus, the decisions cannot be applied beyond their specific facts.

Many of the Commission's established doctrines have been based purely on the Commission's expert judgment. In *Pfizer, Inc.*,<sup>137</sup> the Commission determined that it was an unfair act to make claims without first having a reasonable basis to substantiate such claims.<sup>138</sup> The Commission determined that consumers are at a distinct disadvantage, vis-à-vis manufacturers and distributors, in gaining information about a product. Manufacturers are in a better position to efficiently test such claims. Therefore, the Commission concluded, it is unfair practice to make an affirmative product claim without a reasonable basis.<sup>139</sup>

The Commission also determined in *Pfizer* that affirmative product claims without prior substantiation were deceptive.<sup>140</sup> Any affirmative claim about a product's quality would imply to consumers that at the time the claim was made, the seller had sub-

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'considerable weight' to the meaning given a statute by the agency charged with administering it.").

<sup>135</sup> See, e.g., *United States v. JS & A Group, Inc.*, 716 F.2d 451, 457 (7th Cir. 1983) (violation of Mail Order Rule, 16 C.F.R. § 435 (1986)); *FTC v. Virginia Homes Mfg. Corp.*, 509 F. Supp. 51, 54 (D. Md.), *aff'd*, 661 F.2d 920 (4th Cir. 1981) (violation of Magnuson-Moss Warranty Act).

<sup>136</sup> See *American Home Prods. Inc. v. FTC*, 695 F.2d 681, 687 n.10 (3d Cir. 1983); *Pitofsky*, *supra* note 64, at 677-79.

<sup>137</sup> 81 F.T.C. 23 (1971).

<sup>138</sup> *Id.* at 23.

<sup>139</sup> *Id.* at 62. "Absent a reasonable basis for a vendor's affirmative product claims, a consumer's ability to make an economically rational product choice, and a competitor's ability to compete on the basis of price, quality, service or convenience, are materially impaired and impeded." *Id.*

<sup>140</sup> See *id.* at 58-59.



stantiation for it. If the substantiation did not exist, the implied representation would not be true; hence, the advertisement would be deceptive. In *Pfizer*, the Commission did not find an affirmative claim which implied existing substantiation. In that same year, however, in *In re Firestone Tire & Rubber Co.*,<sup>141</sup> the Commission found that representations made by Firestone that its tires were "the safe tire," and that one of its tires would "stop 25% quicker," constituted affirmative claims that were deceptive because they lacked prior substantiation.<sup>142</sup>

In the *Pfizer* and *Firestone* opinions, the Commission cited no studies or other evidence that consumers actually believed that the representations had prior substantiation. The Commission cited no studies on the relative costs to producers and consumers of acquiring the information, or the possible effects of always requiring prior substantiation of product claims. The Commission relied on its own expertise.<sup>143</sup>

In a more recent case, *In re International Harvester Co.*,<sup>144</sup> the Commission said that it is now using more rigorous analysis, but the decision in that case rests essentially on the Commission's expert judgment.<sup>145</sup>

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<sup>141</sup> 81 F.T.C. 398 (1972), *aff'd*, 481 F.2d 246 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973).

Since these cases, the Commission has repeatedly used the prior substantiation doctrine to find advertisements either unfair or deceptive; courts have constitutionally upheld these findings. *See, e.g.*, *Bristol-Myers Co.*, 102 F.T.C. 21 (1983), *aff'd*, 738 F.2d 544 (2d Cir. 1984); *Jay Norris, Inc.*, 91 F.T.C. 751 (1978), *aff'd as modified*, 598 F.2d 1244 (2d Cir.), *cert. denied*, 444 U.S. 980 (1979); *Porter & Dietsch, Inc.*, 90 F.T.C. 770 (1977), *aff'd as modified*, 605 F.2d 294 (7th Cir. 1979), *cert. denied*, 445 U.S. 950 (1980); *National Dynamics Corp.*, 82 F.T.C. 488 (1973), *aff'd as modified*, 492 F.2d 1333 (2d Cir.), *cert. denied*, 419 U.S. 993 (1974).

The Commission has also run an advertising substantiation program for over a decade, requiring businesses to provide the Commission with the substantiation for representations. *See FTC's Policy Statement on Advertising Substantiation Program*, 47 Antitrust & Trade Reg. Rep. (BNA) 234 (Aug. 2, 1984); Federal Trade Commission, Special Report Relating to Advertising Claims, 36 Fed. Reg. 12,058 (1971); *see also* Note, *The FTC Ad Substantiation Program*, 61 GEO. L.J. 1427, 1429-1440 (1973) (business must substantiate most claims made regarding advertised product).

<sup>142</sup> *See Firestone Tire & Rubber Co.*, 81 F.T.C. at 451-52.

<sup>143</sup> As recently as 1982, commentators have criticized the lack of empirical support for the prior substantiation doctrine. Tolleson, "Efficiency", "Cost Benefits" and Other Key Words—The Practical Uses of Economics at the FTC, 51 ANTITRUST L.J. 581, 584-85 (1982). *See also* Craswell, *supra* note 97, at 709-14 (substantiation doctrine lacks definition of what is "reasonable basis" for claim); Pitofsky, *supra* note 64, at 681-83 (substantiation program questionable in value, costs and benefits and perhaps constitutionally infirm).

<sup>144</sup> 104 F.T.C. 949 (1984).

<sup>145</sup> *Id.* In *International Harvester*, the practice complained of was International Har-

### *E. Courts Cannot Rely on General Deception Principles*

The Commission realizes that courts cannot rely on Commission precedents. In its non-rule violation section 13(b) actions, the Commission, with one exception, has not relied on specific existing Commission precedents to guide the courts.<sup>146</sup> Rather, it has primarily brought cases against companies similar to those in *FTC v. U.S. Oil & Gas*<sup>147</sup> and *FTC v. Kitco of Nevada, Inc.*<sup>148</sup> The practices there were so egregiously deceptive that the courts found the practices illegal with little or no analysis of whether the practices were either unfair or deceptive. The Commission's clear violation standard worked only because the practices were so outrageous that the courts did not have to delve into the meaning of section 5. The proposed standard of a misrepresentation of material fact also would have clearly reached these schemes.

The Commission's clear violation standard has not worked in cases alleging less egregious practices. In three cases, *FTC v. Furman*,<sup>149</sup> *FTC v. Evans Products Co.*,<sup>150</sup> and *FTC v. Brown & Williamson Tobacco Corp.*,<sup>151</sup> the Commission attempted to rely on general principles of section 5 deception. The Commission failed to secure at least part of the relief it sought in all of these cases. These cases demonstrate that courts cannot, or will not, apply the Commission's general principle of a section 5 deception consistently with either Commission precedents or each other.

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vester's failure to disclose to customers the danger of fuel geysering (heated gasoline shooting out of gas tank in streams up to 20 feet high) in its gasoline-powered tractors if the gas cap was loosened or removed while the engine was running. *Id.* at 1051-55. In concluding that the practice was unfair, the Commission cited no analysis of the costs to International Harvester to notify customers, or whether the notice would reduce the threat of accidents. Nor did the Commission cite anything other than anecdotal evidence concerning whether customers would anticipate the danger of fuel geysering and avoid the harm without the company's notice. *See id.* at 1064-67.

<sup>146</sup> *FTC v. Intra-Medic Formulations, Inc.*, No. 85-2819 (S.D. Fla. filed Aug. 11, 1985) (§ 5(m) claim for civil penalties combined with the § 13(b) action). The FTC in *Intra-Medic* relied upon *Porter & Dietsch, Inc.*, 90 F.T.C. 770 (1977) (involving weight reduction plans), *aff'd as modified*, 605 F.2d 294 (7th Cir. 1979), *cert. denied*, 445 U.S. 950 (1980), and *Keele Hair & Scalp Specialists, Inc.*, 55 F.T.C. 1840 (1959) (involving baldness cures), *aff'd*, 275 F.2d 18 (5th Cir. 1960).

<sup>147</sup> No. 83-1702 CIV-WMH (S.D. Fla. filed July 7, 1983). *See supra* note 108 and accompanying text.

<sup>148</sup> 612 F. Supp. 1282 (D. Minn. 1985). *See supra* note 110 and accompanying text.

<sup>149</sup> No. 84-803-A, slip op. (E.D. Va. Jan. 30, 1985).

<sup>150</sup> No. C85-45M (W.D. Wash. order denying injunctive relief filed Feb. 27, 1985), *aff'd*, 775 F.2d 1084 (9th Cir. 1985).

<sup>151</sup> 580 F. Supp. 981 (D.D.C. 1983), *aff'd in part*, 778 F.2d 35 (D.C. Cir. 1985).

Before discussing these cases in detail, a brief description of current Commission deception analysis is in order. The description is necessary to understand the inconsistencies between these cases and current Commission analysis, as well as the problems that such judicial decisions may cause in the future.

## 1. General Principles of Deception

Complicating any court's ability to apply the Commission's general deception principles is the current uncertainty about those principles. Prior to 1983, the Commission defined deception as an act that had a tendency or capacity to deceive consumers.<sup>152</sup> The Commission then changed the wording of the definition of deception to an act that: (1) had a likelihood to deceive consumers; (2) acting reasonably in the circumstances; (3) in a material way (or to their detriment).<sup>153</sup> The Commission claims that the new wording did not change the existing law, but only clarified it.<sup>154</sup> Under either wording, a practice, usually a representation or omission, is deceptive if it has a sufficient potential to deceive a sufficient number of appropriate consumers to a sufficient degree. The actor's intent is irrelevant.<sup>155</sup>

The Commission's decisions and policy statements have added to these criteria. The pre-1983 decisions typically described the sufficient potential to deceive as a "tendency or capacity to mislead."<sup>156</sup> The Commission's new wording is "likelihood or propen-

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<sup>152</sup> *Id.*

<sup>153</sup> *FTC's Policy Statement on Deception Sent to Chairmen of the Senate Commerce, Science and Transportation Comm. and House Energy and Commerce Comm., reprinted in 45 Antitrust & Trade Reg. Rep. (BNA) 689-90, 694 (Oct. 14, 1983) [hereinafter *FTC Deception Statement*].*

<sup>154</sup> This writer believes the new Commission standard will make it more difficult to prove deception. The Ninth Circuit ruled that the new standard imposed a higher burden of proof on the Commission. *Southwest Sunsites, Inc. v. FTC*, 785 F.2d 1431, 1436 (9th Cir. 1986). For further discussion of this issue, see Bailey & Pertschuk, *The Law of Deception: The Past as Prologue*, 33 AM. U.L. REV. 849 (1984); Craswell, *supra* note 97, at 696-714; Fraser, *supra* note 64, at 551-62; Sullivan & Marks, *The FTC's Deceptive Advertising Policy: A Legal and Economic Analysis*, 64 OR. L. REV. 593, 604-18 (1986); *Deception Policy Statement Prepared by Commissioners Bailey and Pertschuk and Transmitted on Feb. 29 to the House Energy and Commerce Committee, reprinted in 46 Antitrust & Trade Reg. Rep. (BNA) 372, 379-87 (Mar. 1, 1984) [hereinafter *Dissenting Deception Statement*].*

<sup>155</sup> See *FTC v. Algoma Lumber Co.*, 291 U.S. 67, 78-81 (1934); *Regina Corp. v. FTC*, 322 F.2d 765, 768 (3d Cir. 1963).

<sup>156</sup> See, e.g., *American Home Prods. Corp. v. FTC*, 695 F.2d 681, 687, n.10 (3d Cir. 1983). See *Dissenting Deception Statement*, *supra* note 154, at 379-87.

sity of deception.”<sup>157</sup> Neither wording requires the Commission to find actual deception, only the potential for deception. In making this determination, the Commission looks at the overall impression of the representation. If the overall impression is subject to multiple interpretations, and one interpretation is deceptive, the representation is deceptive. Even if the representation is literally true, as long as the overall impression is deceptive, the representation violates section 5. Representations that omit material information are deceptive. Affirmative claims about a product or service which the seller has not previously substantiated are deceptive because they imply that such substantiation exists.<sup>158</sup> General slogans such as “Coke Is It” or “Baseball, Hot Dogs, Apple Pie and Chevrolet” or “the best hamburger in town,” however, are deemed to be mere puffery and are not deceptive.<sup>159</sup>

The deceptive practices must have the potential to deceive a sufficient number of appropriate consumers.<sup>160</sup> The Commission has kept this requirement flexible. One case has indicated that less than fifteen percent could be a sufficient number.<sup>161</sup> The percentage may vary according to the nature of the deceptive practice and the severity of the potential harm. Threats to health and safety would be deceptive even though they deceived very few appropriate consumers.<sup>162</sup>

The appropriate consumer has been described as the “‘aver-

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<sup>157</sup> *FTC Deception Statement*, *supra* note 153, at 690-91.

<sup>158</sup> See *Pfizer, Inc.*, 81 F.T.C. 23, 58-59 (1971). See also *supra* notes 137-41 and accompanying text.

<sup>159</sup> In the *Analgesics* cases, for example, representations such as “Bayer works wonders,” were mere puffery, but other claims designed to create the impression that a given non-prescription, aspirin-based pain reliever was unique or better than the others were found to be deceptive. See *Bristol-Myers Co. v. FTC*, 738 F.2d 554, 562-63 (2d Cir. 1984) (citing *FTC v. Sterling Drug, Inc.*, 317 F.2d 669, 674 (2d Cir. 1963)); *American Home Prods. Corp. v. FTC*, 695 F.2d 681, 707 (3d Cir. 1983).

The Commission also found two of the advertisements misleading because of omissions. In *Bristol-Meyers*, the Commission found deceptive the claim that doctors recommended Bufferin more than any other “leading brand” because the advertisement omitted the fact that some data indicated that doctors recommended Tylenol, Ascriptin and generic aspirin more often than Bufferin. *Bristol-Meyers*, 738 F.2d at 563. In *Sterling Drug*, the Commission found representations that Midol had an “exclusive formula” to be deceptive because the advertisement failed to disclose that Midol contained aspirin. *Sterling Drug, Inc. v. FTC*, 741 F.2d 1146, 1154 (9th Cir. 1984).

<sup>160</sup> See *Dissenting Deception Statement*, *supra* note 154, at 387-94.

<sup>161</sup> See *Firestone Tire & Rubber Co.*, 81 F.T.C. 398, 451-54, *aff'd as modified*, 481 F.2d 246, 249 (6th Cir.), *cert. denied*, 414 U.S. 1112 (1973).

<sup>162</sup> See *Dissenting Deception Statement*, *supra* note 154, at 393.

age' or 'ordinary' person in the audience addressed,"<sup>163</sup> or "someone of any intelligence."<sup>164</sup> The courts have described these persons essentially as the "trusting,"<sup>165</sup> or the "ignorant, unthinking and the credulous."<sup>166</sup> The Commission has said though, that the appropriate consumer does not include the fool. The Commission's classic example is that it will not protect persons who would believe that all Danish pastry is imported from Denmark.<sup>167</sup> The Commission's 1983 wording refers to misleading consumers "acting reasonably under the circumstances."<sup>168</sup>

The Commission has added a caveat that it may test practices directed at particular segments of the population according to their potential to deceive those appropriate consumers.<sup>169</sup> The Commission has used this principle largely to adopt a higher standard to protect groups perceived as particularly vulnerable, such as children<sup>170</sup> or pregnant women.<sup>171</sup>

<sup>163</sup> Pitofsky, *supra* note 64, at 675.

<sup>164</sup> See Millstein, *supra* note 64, at 460; Note, *supra* note 64, at 1040-43.

<sup>165</sup> See *FTC v. Standard Educ. Soc'y*, 302 U.S. 112, 116 (1937).

The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. There is no duty resting upon a citizen to suspect the honesty of those with whom he transacts business. Laws are made to protect the trusting as well as the suspicious. The best element of business has long since decided that honesty should govern competitive enterprises, and that the rule of *caveat emptor* should not be relied upon to reward fraud and deception.

*Id.*

<sup>166</sup> *Aronberg v. FTC*, 132 F.2d 165, 167 (7th Cir. 1942).

<sup>167</sup> See *Heinz W. Kirchner*, 63 F.T.C. 1282, 1290 (1963), *aff'd*, 337 F.2d 751 (9th Cir. 1964).

<sup>168</sup> *FTC Deception Statement*, *supra* note 153, at 691-93. To be consistent with the case law, "acting reasonably" must refer to the consumer's act of perceiving and understanding the representation and not his or her subsequent decision based on that understanding. See *Craswell*, *supra* note 97, at 699-704 (no definition of "reasonableness" in cases discussed in *FTC Deception Statement*). Thus, the one who has the impression that the phrase "Danish pastry" means imported from Denmark is not "acting reasonably." But the one who is told in an unsolicited telephone sales presentation that he will make a fortune if he sends \$3,000 to an address on the other side of the country "acts reasonably" when he understands the representation to be that he will make a fortune, even though he would arguably have to be very trusting or unthinking to actually believe the representation and send the check.

<sup>169</sup> See *Dissenting Deception Statement*, *supra* note 154, at 390-91; Pitofsky, *supra* note 64, at 676.

<sup>170</sup> See, e.g., *FTC v. R.F. Keppel & Bros., Inc.*, 291 U.S. 304, 313 (1934) (competitive method which exploits children "who are unable to protect themselves" unfair); *Stuppell Originals, Inc.*, 67 F.T.C. 173, 187-88 (1965) (failure to disclose possibility of injury to children consumers unfair and deceptive practice).

<sup>171</sup> See, e.g., *Savitch*, 50 F.T.C. 828, 834 (1954) (advertisement playing on fears of preg-

Finally, the potential deception must be sufficiently significant. This element has not been a significant issue in the case law. In *American Home Products Corp. v. FTC*, the Third Circuit said that, "[o]nce the Commission finds deception, it is normally allowed to infer materiality."<sup>172</sup> As long as the deceptive practice might have some effect, it is material. The deception does not have to be the deciding factor in the consumer's decision. It is clear from prior decisions that the Commission is not required to find actual injury resulting from the deception.<sup>173</sup> The new formulation states that the deception is material if it would likely cause consumers to act to their detriment, but, again, does not require proof of actual injury. Even with its embellishments, the Commission's deception principles call for the decisionmaker to divine possible effects of practices that may harm some consumers. Furthermore, these principles are so open-ended that the courts cannot apply them consistently with the Commission.<sup>174</sup> Three cases, *FTC v.*

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nancy constitutes unfair and deceptive act), *aff'd*, 218 F.2d 817 (2d Cir. 1955).

<sup>172</sup> *American Home Prods. Corp. v. FTC*, 695 F.2d 681, 688, n.11 (3d Cir. 1983) (citing *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 391-92 (1965)). See *Dissenting Deception Statement*, *supra* note 154, at 394-98.

<sup>173</sup> See, e.g., *Southwest Sunsites, Inc.*, 105 F.T.C. 7, 147-50 (1985), *aff'd*, 785 F.2d 1431 (9th Cir. 1986); *Thompson Medical Co.*, 104 F.T.C. 648, 788-91 (1984); *Cliffdale Assocs.*, 103 F.T.C. 110, 165-74 (1984). See *Fraser*, *supra* note 64, at 551-62 (indicating that Commission may be requiring more extrinsic evidence of meaning of a representation, but not evidence of actual injury).

See also *FTC Deception Statement*, *supra* note 153, at 690. Certain types of claims are presumptively material: express claims; false claims; omitted information which "the seller knew, or should have known" consumers would need; and representations "pertaining to the central characteristics of the product or service." Claims or omissions significantly involving "health, safety or other areas with which the reasonable consumer would be concerned" are also now considered material. The Commission will infer materiality in an implied claim "that a seller intended to make." *Id.* at 694.

<sup>174</sup> Courts apply a standard similar to section 5 deception in private actions under section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a) (1982). See *FTC v. Brown & Williamson Tobacco Corp.*, 778 F.2d 35, 40 n.2 (D.C. Cir. 1985); *Skil Corp. v. Rockwell Int'l Corp.*, 375 F. Supp. 777, 781-83 (N.D. Ill. 1974); J. MCCARTHY, TRADEMARKS AND UNFAIR COMPETITION 358-59 (1984); Keller, *Private Regulation of Advertising under Section 43(a) of the Lanham Act*, 1985 ANN. SURV. AM. L. 563. But even if courts have experience with a similar standard, this does not show any competence to interpret section 5 consistently with the Commission. See *Brown & Williamson*, 778 F.2d at 40 n.1. The section 13(b) cases indicate that they cannot.

In 1977, Professor Pitofsky hinted at the possibility of section 13(b) actions, but believed that little would come of it because of the difficulty of proving section 5 deception and stated that "[t]his statute may not lead to new remedial initiatives, because, except for blatant frauds, deceptive advertising cases involve complicated evidentiary issues relating to the meaning of the and the adequacy of substantiation." Pitofsky, *supra* note 64, at 692-93 n.128.

*Furman*,<sup>175</sup> *FTC v. Evans Products Co.*,<sup>176</sup> and *FTC v. Brown & Williamson Tobacco Corp.*,<sup>177</sup> demonstrate this point.

## 2. *FTC v. Furman*

In *Furman*, the court rejected the Commission's evidence of fraud, but still found the defendant's practices to be deceptive. The defendants offered "hair analysis" services and advertised in both medical professional journals and popular magazines.<sup>178</sup> For \$36.95, defendants would perform a spectroscopic analysis of a person's hair. Defendants' popular magazine advertisements stated that hair analysis would show your "body's mineral excesses and deficiencies," and the report would "clearly recommend WHICH supplements to take and WHEN to take them." Defendants' advertisements in health care professional journals represented that hair analysis was, "more accurate than blood or urine analysis to measure toxic and nutrient mineral levels." Customers would mail hair samples and \$36.95 to the defendants in return for a computer printout and a list of recommended vitamins and other nutritional supplements. At the same time, in a separate mailing under a different corporate name, they also sent materials offering for sale the vitamins, minerals and other supplements which the report recommended.<sup>179</sup>

The Commission sent in six hair samples over six weeks to the defendants, and concurrently had the Food and Drug Administration (the "FDA") test samples from the same hair. According to the FDA, the defendants' analyses were substantially incorrect. The defendants explained that their equipment was not working properly during this particular period and was replaced shortly thereafter. The court believed the defendants' explanation of malfunctioning machinery and did not find deception based on the Commission's six samples.<sup>180</sup>

The court did find deception, however, in the defendants' advertising directed toward the general public. These advertisements gave the impression that the personalized hair analysis would, by itself, give the consumer sufficient information to know what nutri-

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<sup>175</sup> No. 84-0803 (E.D. Va. Jan. 30, 1985).

<sup>176</sup> No. C85-45m (W.D. Wash. Feb. 28, 1985), *aff'd*, 775 F.2d 1084 (9th Cir. 1985).

<sup>177</sup> 580 F. Supp. 981 (D.D.C. 1983), *aff'd in part*, 778 F.2d 35 (D.C. Cir. 1985).

<sup>178</sup> *FTC v. Furman*, No. 84-0803-A, slip op. at 3-7 (E.D. Va. Jan. 30, 1985).

<sup>179</sup> *Id.* at 6.

<sup>180</sup> *Id.* at 7-8.

tional supplements he or she needed. The advertisements were found to be deceptive because:

the consumer is not told in the advertisements, as he or she ought to be told, that hair analysis is only a guide, not a panacea, to be used with a health care professional in determining what mineral excesses and deficiencies exist in the whole body and what nutrients to take to correct those excesses and deficiencies.<sup>181</sup>

The court was clearly concerned that consumer self-medication, based only on the hair analysis, was a health threat.<sup>182</sup>

The court found a deceptively unqualified representation of fact and, thus, granted injunctive relief. The rest of the court's opinion indicated that absent a clear deception, it would not grant relief. In so doing, the court ignored and, arguably, ruled inconsistently with, current Commission deception analysis. The court stated that the defendants included adequate disclaimers with the printout report<sup>183</sup> but that the disclaimers failed to alleviate the deception because "they [came] *after* the customer has parted with his or her \$36.95," and because they were lost when surrounded by the other claims and marketing techniques.<sup>184</sup>

The court implied that the disclaimers would prevent deception if properly placed in the initial advertisements. Under current Commission analysis, however, even qualified statements, if made in connection with affirmative claims, would be deceptive unless supported by prior substantiation.<sup>185</sup> The disclaimers still repre-

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<sup>181</sup> *Id.* at 11.

<sup>182</sup> *Id.* at 10. The court emphasized, "[we] are here dealing with health care—not a sale of vacuum cleaners." *Id.*

<sup>183</sup> *Id.* at 9. The disclaimers said:

[A]ll of the above information is not intended to be for the diagnosis, prevention or treatment of any disease, or for the assessment of any medical condition. . . . [T]he following recommended supplementation in your diet is not meant to be prescriptive but as a guide for a healthier, happier life . . . . [F]or best results it is recommended that these supplements be taken after consultation with your nutritionist or nutritionally oriented physician.

Complaint exhibit D, *FTC v. Furman*, No. 84-803-A (E.D. Va. filed Aug. 7, 1984). The court's analysis closely tracks the Commission's prior substantiation doctrine. The unqualified statements are deceptive because the existing scientific evidence does not support them and the qualifiers are inadequate because they are not available to consumers at the point of sale. *See supra* notes 137-42 and accompanying text. The Commission did not plead that the advertisements were deceptive because they lacked prior substantiation, which may indicate that the Commission does not want courts to set precedents concerning issues such as what is a sufficient reasonable basis for a representation.

<sup>184</sup> *Furman*, No. 84-0803-A, slip op. at 8-10 (E.D. Va. Jan. 30, 1985).

<sup>185</sup> *See supra* notes 137-42 and accompanying text.



sented hair analysis to be "a guide for a healthier, happier life." Based on Commission precedent, this representation may still constitute an affirmative claim.<sup>186</sup> If it does, the scientific evidence probably does not support it. The court said the evidence, "at best," showed a hair analysis to be a useful guide "only to health care professionals."

The *Furman* court also refused to enjoin advertisements directed to health care professionals. The court reasoned that "[t]he evils present in advertisements aimed at and reports received by direct consumers without the intervention of a health care professional, do not exist when the hair sample is submitted by, and the report rendered to, a health care professional."<sup>187</sup> If the court meant that the advertisements directed at this particular group—health care professionals—did not have a tendency or likelihood to deceive them, and, therefore, presented no "evil," this would be consistent with the Commission's deception standard.

However, the court more likely meant that the threat of injury to consumers' health through self-medication would not be present when analyses were sent to professionals. If so, the court changed the central focus of its analysis from whether the representations or practices had a tendency or likelihood to deceive to whether actual injury would result. Proof of injury has never been part of section 5 deception analysis. Even the Commission's new emphasis on materiality would find affirmative representation, such as hair analysis is more accurate than blood or urine analysis, to be material.<sup>188</sup> The *Furman* court, in its analysis of both the disclaimers and the potential to deceive professionals, seemed to require a material misrepresentation of fact. More significantly, it has at least implied that proof of actual injury is necessary to award monetary relief under section 5. If the proposed standard had been in place, the court would have enjoined the same activity and would have avoided a judicial interpretation of section 5 inconsistent with Commission precedent.

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<sup>186</sup> Cf. *Firestone Tire & Rubber Co.*, 81 F.T.C. 398, 458 (1972), *aff'd*, 481 F.2d 246 (6th Cir. 1973), *cert. denied*, 414 U.S. 1112 (1973) (Firestone's statement "the safe tire" was an affirmative representation that its tires were free from manufacturers' defects).

<sup>187</sup> *Furman*, No. 84-0803-A, slip op. at 12 (E.D. Va. Jan. 30, 1985).

<sup>188</sup> See *supra* note 173.

### 3. *FTC v. Evans Products Co.*

In *Evans Products*, the Commission alleged that Evans sold do-it-yourself home building kits through high interest consumer credit loans and represented to purchasers that, upon completion of the home, purchasers would receive long term loans at lower rates. The Commission alleged that lower interest loans were not provided.<sup>189</sup> The Commission sought a preliminary injunction to stop Evans Products from foreclosing on the consumers' houses. The trial court denied the Commission's motion for a preliminary injunction because Evans Products had stopped selling the house kits more than two years earlier.<sup>190</sup> The court also held that the Commission did not demonstrate a sufficient likelihood of success on the merits because the written materials "[did] not appear to be misleading to an average and unsophisticated person," and that there was "some leeway for a certain amount of 'puffing.'" <sup>191</sup> The court further noted that the defendants' representation did not violate Truth-in-Lending Act regulations.<sup>192</sup>

The *Evans* court did not explain why the representations did not reach the level of a tendency or likelihood to deceive. It did not even quote the questioned representations. Like the court in *Furman*, the court seemed willing to let stand ambiguous statements short of material misrepresentations of fact. Also, like *Furman*, the court interpreted section 5 inconsistently with the Commission's deception standard, particularly with reference to Truth-in-Lending Act regulations. The court at least implied that such regulations were a safe harbor from section 5 claims. Those regulations are irrelevant to deception analysis.<sup>193</sup>

### 4. *FTC v. Brown & Williamson Tobacco Corp.*

In *Brown & Williamson*, unlike *Furman* and *Evans*, the court rigorously applied the Commission's deception analysis; although in the end, it still seemed to require proof of a misrepresentation

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<sup>189</sup> Plaintiff's Complaint ¶¶ 8-29, *FTC v. Evans Prods. Co.*, No. C85-45M (W.D. Wash. filed Jan. 11, 1985).

<sup>190</sup> *FTC v. Evans Prods. Co.*, No. C85-45M, slip op. at 3-5 (W.D. Wash. filed Feb. 28, 1985), *aff'd*, 775 F.2d 1084 (9th Cir. 1985).

<sup>191</sup> *Id.* at 5. The court said proof of oral misrepresentation would require extensive testimony not yet presented before the court. *Id.* at 6.

<sup>192</sup> *Id.* at 7.

<sup>193</sup> See, e.g., *Horizon Corp.*, 97 F.T.C. 464, 863-64 (1981) (compliance with regulations cannot be construed as immunizing a company from scrutiny under § 5).

of material fact. Indeed, in one part of the opinion, the court arguably decided the case inconsistently with the Commission's standard. Brown & Williamson Tobacco Corp. ("B&W"), a major cigarette manufacturer, had developed the Barclay, an ultra-low tar cigarette. Since 1970, the FTC has tested cigarettes for tar and nicotine content. Manufacturers, including B&W, voluntarily printed the FTC ratings on their packaging and advertising.<sup>194</sup> Although the Barclay initially tested at one milligram tar,<sup>195</sup> the Commission later determined that the rating was inaccurate. The Barclay's filter was designed to produce more tar when smoked by humans than when smoked by testing machines and actually delivered more tar to smokers than comparably rated cigarettes.<sup>196</sup> The Commission, after discovering this fact, deleted its rating of the Barclay.<sup>197</sup>

B&W, however, continued to advertise the Barclay as a one milligram tar cigarette. The advertisement's fine print stated the rating was by a method supported by independent laboratories. But for the small print, the one milligram tar rating appeared identical to FTC rating disclosures on other cigarette advertising.<sup>198</sup> B&W also advertised that the Barclay was "99% tar free."<sup>199</sup> The Commission sued to enjoin B&W's representations. The Commission alleged that the one milligram claim would deceptively mislead consumers into believing that the Barclay was comparable to cigarettes rated one milligram by the FTC, and that the "99% tar free" slogan deceptively suggested to consumers that the Barclay was "virtually free of tar."<sup>200</sup>

The court decided that consumers would believe the Barclay rating to be comparable to FTC ratings. Moreover, B&W had previously admitted the importance of the ratings to consumers. In a related proceeding, B&W sued the FTC to enjoin withdrawal of the FTC one milligram rating of the Barclay, alleging that the FTC ratings had become a "vital part of the industry" because consumers had come "to accept and rely upon those numbers."<sup>201</sup>

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<sup>194</sup> *FTC v. Brown & Williamson Tobacco Corp.*, 580 F. Supp. 981, 983 n.7 (D.D.C. 1983), *aff'd in part*, 778 F.2d 35 (D.C. Cir. 1985).

<sup>195</sup> *Id.* at 983.

<sup>196</sup> *Id.* at 983-84.

<sup>197</sup> *Id.* at 984.

<sup>198</sup> *Id.* at 986-87.

<sup>199</sup> *Id.* at 983.

<sup>200</sup> *Id.* at 984.

<sup>201</sup> *Id.* at 983 n.8.

The court, relying on expert testimony and the appearance of the advertisement, decided that the fine print disclosure acknowledging the rating to be other than the FTC's was inadequate. The disclosure did not change the overall impression that the one milligram tar rating was comparable to the FTC one milligram tar ratings. The court also noted that no disclosure appeared on the cigarette package itself. Based on this, and the scientific evidence that the Barclay was not comparable to other one milligram cigarettes, the court enjoined Barclay's one milligram claim.<sup>202</sup>

The court found the one milligram claim to be a misrepresentation of fact because B&W conceded that consumers considered tar and nicotine ratings material and used such ratings to compare brands. B&W, thus, published a rating which was not comparable to ratings on other brands, but which B&W conceded consumers would believe was comparable.

Relying primarily on consumer surveys, the *Brown & Williamson* court rejected the Commission's allegation that the "99% tar free" claim was deceptive.<sup>203</sup> The court concluded that consumers did not associate "99% tar free" claim with any particular milligram tar rating but, at best, considered the representation a general low tar claim.

The court ruled this way despite B&W's survey which indicated that ten percent of those questioned who were familiar with the Barclay ads associated the "99% tar free" claim with one milligram tar.<sup>204</sup> Cigarette smoking directly affects consumers' health; thus, the percentage of consumers potentially deceived about the tar content of the Barclay should not have to be large to establish a tendency to deceive.<sup>205</sup> The ten percent figure might have been sufficient under the Commission analysis.

#### F. Effectiveness of the Proposed Standard

The proposed standard would have worked well in the Commission's cases to date. The Commission would have reached rule violations and violations of other statutes, as well as those egregious experience and credence goods situations, such as *U.S. Oil &*

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<sup>202</sup> *Id.* at 986-90.

<sup>203</sup> *Id.* at 989-90.

<sup>204</sup> *Id.* at 989 n.50.

<sup>205</sup> See *supra* notes 160-62 and accompanying text; see also *Dissenting Deception Statement*, *supra* note 154, at 393 (sellers of products which may cause personal harm should be subject to more stringent advertising standards than others).

*Gas* and *Kitco*,<sup>206</sup> that economic theory suggests should be appropriate for section 13(b) actions. Limiting non-rule violation section 5 proper cases to those involving misrepresentations of material fact would not limit the effective scope of section 13(b) actions. *Furman*, *Evans*, and *Brown & Williamson* indicate that courts will find section 5 violations only on proof of such misrepresentations.

Adopting a misrepresentation of material fact as the standard for non-rule violation section 5 cases would, however, take courts out of the business of interpreting section 5. Courts would decide whether the facts presented a proper case. A ruling against the Commission would not be a finding that the objectionable acts were legal under section 5, but only that the situation was not a proper case for permanent relief under section 13(b).

Without such a formal, separate standard for proper cases, the *Furman*, *Evans*, and *Brown & Williamson* courts established precedents that interpreted section 5 inconsistently with each other and with prior Commission precedents. The *Furman* court focused more on the threat of actual consumer injury through self-medication than on the deceptive characteristics of the advertisements. The *Evans* court implied that other regulatory disclosure requirements were relevant to determining section 5 deception. The *Brown & Williamson* court followed the Commission's "tendency to deceive" analysis, but refused to enjoin a representation that the Commission might well have stopped on the same evidence. Section 13(b) cases such as these would inevitably lead to divergent and conflicting lines of authority on the meaning of section 5.<sup>207</sup> The Commission would not be compelled to follow district court interpretations in its administrative proceedings, but it could not overturn them.<sup>208</sup> In subsequent section 13(b) actions, the district courts would follow their own precedents rather than

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<sup>206</sup> See *supra* notes 108-11 and accompanying text.

<sup>207</sup> The Commission has realized the potential for conflicting interpretations and has demonstrated concern over proposals to authorize state attorney generals to bring actions under section 5. See *60 Minutes with Terry Calvani, Acting Chairman, Federal Trade Commission*, 55 ANTITRUST L.J. 275, 278-79 (1986).

<sup>208</sup> For example, the Commission could have begun cease and desist proceedings against *Brown & Williamson* for the "99% tar free" claim even after the district court's judgment. See *FTC v. Brown & Williamson Corp.*, 778 F.2d 35, 40 n.1 (D.C. Cir. 1985). See also RESTATEMENT (SECOND) OF JUDGMENTS § 28 (1982). Whether the Commission found the representation deceptive would not affect the district court decision's precedential value. In that district, the court's opinion would be controlling in the next case brought by the Commission.

the Commission's opinions. Consequently, at least two separate meanings of "unfair and deceptive" would result.

Adopting the proposed standard for proper cases avoids this problem. It gives section 13(b) actions the scope they theoretically require and, at the same time, returns to the Commission control over the meaning of unfair and deceptive by eliminating trial level judicial interpretations of section 5.

#### IV. THE PROPER PROOF

Although section 13(b) expressly authorizes only injunctions by invoking the equitable jurisdiction of the court, it also authorizes any other appropriate equitable remedy. The Supreme Court, in *Porter v. Warner Holding Co.*,<sup>209</sup> established that whenever a statute authorizes a federal agency to seek an equitable remedy, the district court may fashion any equitable order reasonably necessary for complete justice in light of the statutory purposes.<sup>210</sup> The full panoply of equitable remedies is available unless expressly prohibited by statute.<sup>211</sup> Under this principle, federal courts have awarded broad equitable relief, including equitable monetary judgments, to federal agencies under a variety of federal statutes.<sup>212</sup> Two circuit courts of appeals have upheld the district court's authority to grant broad preliminary and permanent equitable relief under section 13(b).<sup>213</sup> The Commission has sought primarily two remedies in section 13(b) cases: injunctions and equitable monetary redress judgments. It has sought this relief against businesses, owners and operators of these businesses, sales managers, and even

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<sup>209</sup> 328 U.S. 395 (1946).

<sup>210</sup> *Id.* at 400.

<sup>211</sup> *Id.* at 398. "Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied." *Id.*

<sup>212</sup> See, e.g., *Mitchell v. Robert De Mario Jewelry, Inc.*, 361 U.S. 288 (1960) (Secretary of Labor enforcing Fair Labor Standards Act); *Schine Chain Theaters, Inc. v. United States*, 334 U.S. 110 (1948) (Department of Justice enforcing Sherman Act); *CFTC v. Co Petro Marketing Group, Inc.*, 680 F.2d 573 (9th Cir. 1982) (CFTC enforcing Commodities Exchange Act); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972) (SEC enforcing 1933 Securities Act and 1934 Securities Exchange Act). See Ellsworth, *Disgorgement in Securities Fraud Actions by the SEC*, 1977 DUKE L.J. 641, 642-47; Farrand, *Ancillary Remedies in SEC Civil Enforcement Suits*, 89 HARV. L. REV. 1779, 1780-84 (1976).

<sup>213</sup> See *FTC v. U.S. Oil & Gas*, 748 F.2d 1431, 1432 (11th Cir. 1984) (per curiam); *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1111 (9th Cir. 1982). These courts, however, have not examined the proof necessary to secure redress judgments, or the proper measure of recovery.

some sales personnel.<sup>214</sup> To prevent violations during the pendency of the action and to preserve assets, the Commission has also sought and secured preliminary injunctions, asset freeze orders, and appointments of receivers.<sup>215</sup> Equity courts must decide whether the Commission can secure such relief solely on a showing of a proper case, or whether congressional goals dictate that the Commission prove more, such as intent or actual injury.<sup>216</sup> Congress' only express guidance is that there must be proper proof. This section attempts to define what proper proof is in light of congressional goals.

### A. Injunctions

Courts should grant injunctions against deceptive practices on proof of a proper case without regard to injury, intent or any other additional element. Injunctive relief has the prospective, corrective effect always sought by Congress. In the 1914 Act and the Wheeler-Lea Amendment of 1938, Congress sought to stop unfair and deceptive practices in their incipiency without imposing liability for past acts.<sup>217</sup> In 1974, Congress added injunctive relief because cease and desist orders lacked that swiftness.<sup>218</sup> Given Congress' intent, courts should grant prospective injunctive relief just on proof of a proper case. Courts appear to be granting prospective injunctive relief without proof of any additional elements. In *Furman*, *Evans*, and *Brown & Williamson*, the denial of injunctions reflect a failure to prove a misrepresentation of material fact rather than a failure to prove any additional element. In rule violation cases, the courts readily grant injunctive relief on proof of the violation.<sup>219</sup>

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<sup>214</sup> See, e.g., *FTC v. U.S. Oil & Gas*, No. 83-1702 CIV-WMH (S.D. Fla. filed July 7, 1983) (order denying motion to vacate), *aff'd*, 748 F.2d 1431, 1433-35 (11th Cir. 1984) (reprinting district court opinion in appendix). See *Fraud Hearings*, *supra* note 8, at 220-22.

<sup>215</sup> *U.S. Oil & Gas*, 748 F.2d at 1432.

<sup>216</sup> A few district court and magistrate opinions have discussed whether additional elements must be proven and have debated the proper measure of recovery. See *FTC v. Kitco of Nev., Inc.*, 612 F. Supp. 1282, 1292-95 (D. Minn. 1985); *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,708-709 (N.D. Cal. 1983) (mag. opinion); *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,506, at 68,459 (N.D. Cal. 1983) (mag. opinion).

<sup>217</sup> See *supra* notes 42-63 and accompanying text.

<sup>218</sup> See *supra* notes 90-95 and accompanying text.

<sup>219</sup> See *United States v. JS & A Group, Inc.*, 716 F.2d 451, 455-57 (7th Cir. 1983); *FTC v. Virginia Homes Mfg. Corp.*, 509 F. Supp. 51, 58-59 (D. Md.), *aff'd*, 661 F.2d 920 (4th Cir. 1981).

### B. Redress Judgments

Courts have the authority under section 13(b) to fashion any remedy "reasonably necessary for complete justice" in light of the congressional purposes now incorporated into the FTC Act. The 1975 Improvement Act authorized non-punitive equitable monetary remedies for rule violations and for unfair or deceptive practices which a reasonable person would have known under the circumstances were dishonest or fraudulent.<sup>220</sup> Congress authorized these remedies to compensate injured consumers and to deter violations. Thus, courts should develop standards for the proper proof and measures of recovery for redress judgments that will most effectively meet the goals of deterrence and compensation, as mandated by the 1975 Improvement Act.

#### 1. The Need for Deterrence

Of these two goals, deterrence should be paramount. The Commission brings public law enforcement actions. The public, as a whole, benefits far more from deterring future deceptive acts than by compensating specific individuals for past injuries, particularly when injured consumers often have private actions available as a remedy.<sup>221</sup> The Commission should compensate injuries with the recovered funds, but its primary focus should be deterrence. The proper proof and the measure of recovery should thus be set to provide the optimal deterrent effect. An effective deterrent will induce potential wrongdoers to decide against committing wrongful acts because the penalties they could receive for committing those acts outweigh the rewards.<sup>222</sup> The potential wrongdoer, in estimating the penalty he might receive, considers two primary factors:

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<sup>220</sup> FTC Act, § 19, 15 U.S.C. § 57b (1982). *See supra* notes 88-89 and accompanying text. Generally equity will not award relief without a showing of an inadequate remedy at law. *See* D. DOBBS, *supra* note 126, § 9.4, at 618-21; 1 G. PALMER, *supra* note 95, § 3.7(b), at 261-63. This is not a limitation here, though, because Congress determined that equitable relief was appropriate in these cases when it enacted section 13(b). *See supra* notes 90-95, 209-13 and accompanying text.

<sup>221</sup> *See* FTC v. Evans Prods. Co., 775 F.2d 1084, 1087 (9th Cir. 1985). The Ninth Circuit ruled that the Commission could not use section 13(b) against sellers who had long ceased operations because the primary goal of such an action was deterrence, not compensation. *Id.* at 1086-88.

<sup>222</sup> *See* R. POSNER, *ECONOMIC ANALYSIS OF LAW* 205-12 (3d ed. 1986) [hereinafter R. POSNER, *ECONOMIC ANALYSIS*]; Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 172-85 (1968); Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652, 653-57 (1983).



the probability of being punished at all, and the severity of that possible punishment.<sup>223</sup> As the likelihood of punishment decreases, the severity of the penalty must increase to maintain the same deterrent effect.<sup>224</sup> The deterrent effect of section 13(b) actions, therefore, is a function of the probability that wrongdoers will be subject to redress orders, and of the size of the redress judgments themselves.

Absent a statutory change, the deterrent effect of section 13(b) actions is seriously limited. The financial constraints on the Commission and other law enforcement agencies limit the probability that wrongdoers will face either civil or criminal liability. The Commission estimated in 1984 that over 500 deceptive investment schemes similar to those in *U.S. Oil & Gas* and *International Diamond* were in existence, yet the Commission, because of limited resources and other factors, brought only seven actions against such companies.<sup>225</sup> Similarly, the resources of other law enforcement agencies permit only a small number of enforcement actions.<sup>226</sup> Moreover, under the general equity powers invoked by section 13(b), courts may not grant punitive sanctions. Congress expressly prohibited punitive sanctions in its authorization of redress under section 19. Thus, redress orders cannot exceed established equitable compensatory measures of recovery.

Within these limitations, courts should maximize the deterrent effect possible by: (1) awarding the maximum, non-punitive recovery consistent with general equitable principles and (2) keeping the required proper proof to the minimum consistent with the policies of the FTC Act. The less the Commission must prove, the greater the probability that it will secure a judgment. The judicial opinions to date, although not completely consistent, seem to be limiting the necessary proof and awarding the maximum, non-punitive award.

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<sup>223</sup> Becker separates out the probability of being caught as an additional consideration. See Becker, *supra* note 222, at 176-79. For simplicity, this consideration is incorporated into the probability of being punished.

<sup>224</sup> See R. POSNER, *ECONOMIC ANALYSIS*, *supra* note 222, at 207; Becker, *supra* note 222, at 185-90.

<sup>225</sup> See *Fraud Hearings*, *supra* note 8, at 217, 220-22.

<sup>226</sup> See generally *Fraud Hearings*, *supra* note 8.

## 2. The Developing Judicial Standards

### a. *The International Diamond Standard*

Two magistrates' opinions in *FTC v. International Diamond Corp.*,<sup>227</sup> provide the most thorough analysis of the elements of section 13(b) redress awards. The defendants in *International Diamond* sold gemstones at inflated prices by misrepresenting the stones' market value and investment value. The magistrate ruled in the first opinion that the restitutionary measure of recovery for fraudulent misrepresentation—the greater of the claimant's loss or wrongdoer's gain—was the correct measure.<sup>228</sup> The second opinion held that each participant with actual knowledge or reckless indifference would be jointly and severally liable for the greater of the consumer loss or the defendants' gain attributable to that defendant's participation or control of the operation.<sup>229</sup>

The court applied a high restitutionary measure of recovery, usually available for only fraudulent misrepresentation. The measure of recovery for innocent misrepresentation is the amount of the benefit received by the wrongdoer up to the amount of the claimant's loss.<sup>230</sup> The difference often may not be significant. In most of the Commission's fraud cases to date, the consumers' loss has been total. Thus, both the benefit and the loss equalled the amount consumers paid. In these cases the amount of recovery would be the same under either fraudulent or innocent misrepresentation measures.<sup>231</sup> Nevertheless, benefits to wrongdoers and losses to consumers may not always be equal. In such cases, the measure for fraudulent misrepresentation could permit a higher re-

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<sup>227</sup> *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725 (N.D. Cal. 1983) (mag. opinion); *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,506 (N.D. Cal. 1983) (mag. opinion).

<sup>228</sup> *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) at ¶ 68,459. See D. DOBBS, *supra* note 126, §§ 9.2, 9.4, at 595-97, 620-21; 1 G. PALMER, *supra* note 95, § 3.7, at 259-63.

<sup>229</sup> *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,709. The magistrate was following a district court opinion in *FTC v. H.N. Singer, Inc.*, 1982-83 Trade Cas. (CCH) ¶ 65,011, at 70,619 (N.D. Cal. 1982). See *infra* note 227 and accompanying text. The *International Diamond* rulings have been followed in *FTC v. Kitco of Nevada, Inc.*, 612 F. Supp. 1282, 1293 (D. Minn. 1985).

<sup>230</sup> See RESTATEMENT OF RESTITUTION § 155 introductory note (1937); D. DOBBS, *supra* note 126, § 9.4, at 629-31.

<sup>231</sup> See, e.g., *Kitco*, 612 F. Supp. at 1295-96. The *Kitco* court, applying the measure of recovery for fraud, entered a judgment against individual defendants for the total amounts paid by customers, over \$500,000. The amount would have been the same under the measure for innocent misrepresentation. *Id.*

covery. Neither measure alone would provide a meaningful deterrent because the wrongdoer's expected liability would rarely exceed his expected benefit significantly.

The more important deterrent of *International Diamond* may result from the imposition of joint and several liability. Joint and several liability significantly increases the potential liability to which any single wrongdoer might be subject. For example, in *International Diamond*, the estimated consumer losses exceeded \$100,000,000.<sup>232</sup> The threat that each wrongdoer might be liable for the entire loss from schemes such as the one illustrated in *International Diamond* may provide a meaningful deterrent.<sup>233</sup>

The *International Diamond* magistrate also limited the proof of consumer reliance and injury that the Commission had to produce in non-rule violation cases.<sup>234</sup> Usually, the party seeking equitable restitution must prove reliance on the misrepresentation, and prove resulting injury.<sup>235</sup> Requiring the Commission to prove that

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<sup>232</sup> See *Fraud Hearings*, *supra* note 8, at 220. In *FTC v. H.N. Singer*, one sales manager was held liable for the total value of all sales made while he was manager, totaling approximately \$290,000. See *FTC v. H.N. Singer, Inc.*, 1982-83 Trade Cas. (CCH) ¶ 65,011, at 70,619 (N.D. Cal. 1982).

<sup>233</sup> Even the threat of joint and several liability may provide a significant deterrent only if the potential wrongdoers are risk averse. See Easterbrook, Landes & Posner, *Contribution Among Antitrust Defendants: A Legal and Economic Analysis*, 23 J. L. & Econ. 331, 364-65 (1980) (a no contribution rule between joint antitrust tortfeasors provides additional deterrence only if tortfeasors are risk averse).

<sup>234</sup> The Commission might avoid reliance and injury issues entirely by changing its theory of recovery to disgorgement of profits. The Securities and Exchange Commission successfully recovers profits from securities frauds, not to compensate private injured investors, but to deter future violations by removing the profit from fraudulent schemes. See Ellsworth, *supra* note 212, at 642-52; Farrand, *supra* note 212, at 1800-05; Hazen, *Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Methods*, 31 HASTINGS L.J. 427, 446-50 (1979); Jacobs, *Judicial and Administrative Remedies Available to the SEC for Breaches of Rule 10b-5*, 53 ST. JOHN'S L. REV. 397, 413-18 (1979); Comment, *Equitable Remedies in SEC Enforcement Actions*, 123 U. PA. L. REV. 1188, 1194-96 (1975). Since the purpose is to deny profits, proof of actual consumer reliance and injury is irrelevant. Congress authorized the Commission to deter violations as well as compensate individuals. Thus, under the broad authority of section 13(b), the Commission would be able to pursue this theory of recovery.

The disadvantage to a disgorgement theory is that the judgments may sometimes be smaller. See Ellsworth, *supra* note 212, at 649-51; Farrand, *supra* note 212, at 1803-04. The standard measure for disgorgement is the benefit received by the wrongdoer. See *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104-05 (2d Cir. 1972). This measure may be smaller when consumers' losses exceed defendants' gains. Also, it has been argued that since the theory is based on disgorging profits, defendants' expenses and taxes should be deducted. See Ellsworth, *supra* note 212, at 655-61. Because of this smaller recovery, a disgorgement of profit theory is inferior to the current Commission theory of recovery.

<sup>235</sup> See PROSSER & KEETON, *supra* note 95, §§ 107-10, at 740-770.

each customer relied on the misrepresentation and suffered injuries would effectively kill redress actions. The time and expense would be prohibitive.

Recognizing this very practical problem, the *International Diamond* magistrate ruled that the Commission need only prove:

that the alleged dishonest or fraudulent practices were the type of misrepresentation on which a reasonably prudent person would rely, that they were widely disseminated, and that the injured consumers purchased [the product]. The burden then shifts to the defendants to prove that the misrepresentations were not relied upon by the consumers.<sup>236</sup>

The magistrate recognized that proof of actual reliance on the part of all consumers would be a difficult task.<sup>237</sup> In contrast, the *Furman* court seemed to require proof of actual reliance and injury. The court ruled that, because the loss was small (\$36.95 per hair analysis), it would "not be worth a feather" to try to identify injured customers and make refunds.<sup>238</sup> In doing so, the court completely ignored the deterrent purpose of redress judgments. Consequently, the *International Diamond* standard for reliance and injury should become the appropriate standard for non-rule violation cases.<sup>239</sup> Since section 19 expressly authorizes redress awards for any rule violation, no additional proof should be required for redress awards in these cases.

The *International Diamond* magistrate also ruled that the Commission had to prove that each defendant acted either with actual knowledge of the falsity of the representation or with reckless disregard for the truth. The magistrate relied on the dishonest and fraudulent standard in section 19 as a guide for the requisite intent for granting redress under section 13(b).<sup>240</sup> The court, relying on a prior section 19 redress case, *FTC v. Turner*,<sup>241</sup> imposed the mail fraud standard of actual knowledge or reckless indifference or conscious avoidance of the truth.<sup>242</sup> The district court in

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<sup>236</sup> *FTC v. International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,709 (N.D. Cal. 1983). The *Kitco* court followed the *International Diamond* magistrate on this issue. See *FTC v. Kitco of Nev., Inc.*, 612 F. Supp. 1282, 1293 (D. Minn. 1985).

<sup>237</sup> See *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,709.

<sup>238</sup> *FTC v. Furman*, No. 84-0803-A slip op. (E.D. Va. Jan. 30, 1985).

<sup>239</sup> It has been followed in at least one other case. See *Kitco*, 612 F. Supp. at 1292.

<sup>240</sup> *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,706-08.

<sup>241</sup> 1983-1 Trade Cas. (CCH) ¶ 65,244 (M.D. Fla. 1982).

<sup>242</sup> *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,707.

*FTC v. Kitco of Nevada, Inc.* subsequently adopted the *International Diamond* actual knowledge or reckless indifference standard.<sup>243</sup>

Subjective knowledge or reckless indifference, however, is an unnecessarily high standard. The *International Diamond* magistrate correctly looked to section 19 for guidance. It contains the only standard in the FTC Act for awarding consumer redress. However, section 19 contains only an objective "reasonable person" standard for non-rule violation cases, not the mail fraud, knowledge or reckless indifference standard.<sup>244</sup> The *Turner* case, cited by the *International Diamond* magistrate, applied an objective standard. While the *Turner* court referred to the mail fraud statute for guidance in determining which acts fit within "fraudulent or dishonest,"<sup>245</sup> it did not refer to the mail fraud statute in discussing the intent requirement. The *Turner* court ordered redress because a reasonable person would have known the practices in the case were fraudulent or dishonest, not because the defendant in *Turner* actually knew.<sup>246</sup>

In addition to the express language of section 19, the legislative history supports the *Turner* court's interpretation. Congress rejected Senators Magnuson's and Moss's 1971 proposal to permit redress for any unfair or deceptive practice. Congress wanted some level of culpability, but chose an objective standard. The conference report on the final bill refers to the reasonable person standard for imposing liability, not to knowledge or recklessness.<sup>247</sup> The report also states that the Commission should recover for less than criminal conduct.<sup>248</sup> Again, the *International Diamond* magistrate should not have imposed such a high level of intent. Some recovery should be permitted for misrepresentations in non-rule violation cases that meet section 19's objective, reasonable person standard.

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<sup>243</sup> 612 F. Supp. at 1292 (D. Minn. 1985).

<sup>244</sup> The *International Diamond* magistrate noted that section 19 contains a reasonable person standard but nevertheless imposed the actual knowledge standard. *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,725, at 69,706.

<sup>245</sup> *FTC v. Turner*, 1983-1 Trade Cas. (CCH) ¶ 65,244, at 69,450-51 (M.D. Fla. 1982). Even here, the *Turner* court indicated that the mail fraud meaning of fraudulent and dishonest was narrower than the section 19 meaning. *Id.* at 69,451.

<sup>246</sup> *Id.*

<sup>247</sup> H.R. CONF. REP. NO. 1606, 93d Cong., 2d Sess. 41 (1974).

<sup>248</sup> *Id.*

b. *The Proper Proof for Subordinates*

The *International Diamond* court may have imposed a higher intent requirement because it chose the higher measure of recovery usually reserved in equity for intentional misrepresentation.<sup>249</sup> The high level of proof should not pose a difficult problem for the Commission in its cases against owners and operators of defendant companies. For example, in *International Diamond*, the four individual defendants allegedly were involved in the management of the company.<sup>250</sup>

This high intent burden, however, may pose problems in actions against subordinates, such as salespersons who had no direct knowledge of the bases for claims but made representations which a reasonable person would know, under the circumstances, to be fraudulent or dishonest. Fraudulent operators are dependent on sales personnel who will not question the truthfulness of representations. Many salespersons believe that as long as they say only what they are told to say by superiors, no matter how outrageous or improbable, they can escape liability because they relied on their superior. It would be easier to find more salespersons liable under a reasonable person standard than the *International Diamond* standard. If liability can reach such salespersons, the pool of salespersons willing to look the other way may dry up. Imposing liability on subordinates, particularly middle level management, could limit what is known as the "Hydra" effect. The owner operator is sued and shut down, and each middle level manager opens his or her own office so the problem is the same or worse. There is no countervailing reason not to impose at least some redress liability based on an objective standard. Section 19 contains a reasonable person standard which would aid the Commission in deterring violations.

The *International Diamond* measure of recovery, though, may not be appropriate. Generally, equity awards no greater recovery for misrepresentations that fall short of intentional fraud than for innocent misrepresentations.<sup>251</sup> The *Restatement of Restitution* provides some authority for a higher recovery for some negligent

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<sup>249</sup> See *supra* notes 230-31 and accompanying text.

<sup>250</sup> FTC v. *International Diamond Corp.*, 1983-2 Trade Cas. (CCH) ¶ 65,506, at 68,458 (N.D. Cal. 1983).

<sup>251</sup> D. DOBBS, *supra* note 126, § 9.4, at 630-31. See generally 1 G. PALMER, *supra* note 95, § 3.19, at 347-53 (discussion of innocent misrepresentation).

misrepresentations. The *Restatement*, by an express caveat, took no position on whether the recipient of the benefit should be liable for more than the benefit received "where his conduct was not tortious but, because he was negligent . . . , he was more at fault than the claimant."<sup>252</sup> The *Restatement's* introductory note to the section says that the measure of recovery is determined by "the tortiousness of the defendant's conduct or the negligence or other fault of one or both of the parties."<sup>253</sup> It goes on to state that if the defendant's conduct was "tortious," he must compensate the claimant for his loss even if greater than the benefit received. If the defendant's conduct was "consciously tortious," he is liable for profits derived from subsequent dealings in the property, even if they are in excess of the claimant's loss. The note also states that in other situations the overriding principle is that recovery should be "granted to the extent and only to the extent that justice between the parties requires."<sup>254</sup> The *Restatement* seems to distinguish between negligent, tortious, and consciously tortious conduct. The consciously tortious standard corresponds to the *International Diamond* knowledge or reckless indifference standard. The section 19 reasonable person standards could fit within the *Restatement's* "tortious" conduct category whereby defendants would be liable for consumers' losses, even in excess of the defendants' gains; or within the negligence category of the caveat, for which the *Restatement* takes no position.

The imposition of joint and several liability for the total recovery on salespersons who have no authority to control any part of the operation and who have no actual knowledge of the bases for representations made illustrates the difficult case in which the *Restatement* does not take a position. In terms of overall deterrence, the higher liability would improve the Commission's ability to dry up the sales forces of these organizations. The higher standard, however, may actually encourage subordinates to open their own fraudulent operations.<sup>255</sup> The expected liability would not increase if the subordinate opened his own operation, but the expected gain would increase substantially. Thus, equal penalty for subordinates may actually encourage the Hydra effect described earlier. To pre-

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<sup>252</sup> RESTATEMENT OF RESTITUTION § 155, at 612 (1937) (caveat to subsection (1)).

<sup>253</sup> *Id.* at 596, introductory note to §§ 150-59.

<sup>254</sup> *Id.*

<sup>255</sup> See generally R. POSNER, ECONOMIC ANALYSIS, *supra* note 222, at 208. See also Becker, *supra* note 222, at 189-90.

vent this perverse incentive to subordinates, the measure of recovery should be lowered. Subordinates who meet the section 19 reasonable person standard should be liable for consumer losses attributable to their activity up to the benefit they personally received. This measure follows the innocent misrepresentation principles of limiting the maximum recovery to the benefit the wrongdoer received.<sup>256</sup> While this still would be a substantial liability, it would distinguish between such subordinates and the fraudulent actors or the owners and operators of schemes.

### C. *The Need for Greater Penalties*

The proposed standards should give the maximum deterrence possible under the current statutory structure. To provide more effective deterrence, Congress should authorize awards of civil penalties, in addition to redress judgments, against those persons who act knowingly or with reckless disregard for the truth. The small likelihood of punishment dictates that the severity of the punishment be high in order to create an effective deterrent.<sup>257</sup> Civil penalties would provide this higher penalty. Section 5(m) already authorizes civil penalties for willful rule violations. Knowing or reckless deception warrants the same high deterrence.

Civil penalties would also increase the Commission's ability to collect the judgments. The deterrent effect of any penalty is dependent on the assumption that the wrongdoer will actually have to pay the penalty or judgment.<sup>258</sup> A number of defendants in several cases have filed for bankruptcy to avoid paying redress judgments.<sup>259</sup> The Commission, in these cases, stands as a general creditor in bankruptcy and can collect only a small portion of the redress judgment. To collect any more, the Commission must convince the bankruptcy court not to grant the debtor a discharge.<sup>260</sup>

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<sup>256</sup> See 1 G. PALMER, *supra* note 95, § 3.19, at 348-49.

<sup>257</sup> R. POSNER, *ECONOMIC ANALYSIS*, *supra* note 222, at 207-08; Becker, *supra* note 222, at 185-90.

<sup>258</sup> R. POSNER, *ECONOMIC ANALYSIS*, *supra* note 222, at 209.

<sup>259</sup> See *supra* note 11.

<sup>260</sup> 11 U.S.C. §§ 523(a), 727(a) (1982).

The disgorgement of profits theory, *see supra* note 234, may put the Commission in a better position as a claimant in bankruptcy. Under restitution theory, defendants in bankruptcy can argue that the injured consumers, not the Commission, are the actual claimants and that the Commission's claim should be disallowed. *Cf. In re Cannon*, 31 Bankr. 823 (Bankr. E.D. Mo. 1983) (state lacked status as creditor). *But see Nathanson v. NLRB*, 344 U.S. 25, 26-87 (1952) (NLRB is a creditor). The Commission should have a better claim



Civil penalties are not dischargeable in bankruptcy.<sup>261</sup> Bankruptcy would be a less attractive haven and the deterrent effect would be greatly increased because the Commission could levy on post-bankruptcy assets.

## V. CONCLUSION

Section 13(b) gives the Commission a new enforcement tool that potentially may be very effective in stopping fraud quickly and in securing redress for consumers. The scope of this new authority should be formally narrowed to those cases well adapted to judicial action. Such narrowing is necessary to avoid judicial action in cases where the complained of activity, although apparently unfair or deceptive, is actually the proper result of a well-functioning, competitive market. Such narrowing is also necessary to protect the Commission's position as the sole interpreter of the meaning of section 5 unfairness and deception. Congress wants the Commission to continue to develop standards for fair and honest business practices. In order to preserve this role, judicial interpretations that might limit Commission flexibility should be kept to a minimum. This Article proposes that an effective definition for proper cases would be a rule violation, violation of a statute enforced by the Commission other than the FTC Act, or a misrepresentation of material fact. It is narrow enough to exclude close cases and broad enough to include cases within judicial competence.

Once a proper case is established, the proper proof for relief must be defined. Deterrence should be the primary goal of these actions. For maximum deterrence, the principles announced in the *International Diamond* opinions, combined with a lesser, reasonable person standard for subordinates, offers the best alternative for non-rule violation cases. Section 19 expressly authorizes redress for any rule violation. For a truly effective deterrent, though, the Commission needs additional authority to seek civil penalties in egregious cases.

Section 13(b) actions have the potential to be an important tool in the fight against egregious consumer frauds. If developed

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under a disgorgement theory because its claim would be purely in the public interest, not based on individual consumers' injuries. See *supra* note 228.

<sup>261</sup> 11 U.S.C. § 523(a)(7) (1982).

properly, this one-line proviso from the 1970's reforms of the Commission could become the single greatest addition to consumer protection law.